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FIRST SESSION

THURSDAY, MAY 21, 1953—9:30 A.M.
Ohio Union—West Ballroom

Presiding:

R. D. ASHMAN, *President, The Ohio Society of Certified Public Accountants, Ernst & Ernst, Cleveland, Ohio*

Paper: "Management Aspects of Taxation"

JAMES J. MAHON, JR., *Resident Partner, Lybrand, Ross Bros. & Montgomery, Philadelphia, Pennsylvania*

Paper: "A Long Range Tax Program for the Federal Government"

J. A. PHILLIPS, *President, The American Institute of Accountants; J. A. Phillips, Sheffield & Co., Houston, Texas*

MANAGEMENT ASPECTS OF TAXATION

By James J. Mahon, Jr.
Resident Partner, Lybrand, Ross Bros. & Montgomery
Philadelphia, Pennsylvania

American management, as a group, probably is more intensely interested and indeed better informed on the subject of taxation than any other contemporary group, including tax administrators.

As a substantial individual taxpayer, the corporate executive is personally interested in the impact of taxes on himself. As an employer, he is concerned with the effects of taxes on obtaining an adequate, efficient and industrious labor and management supply. And, as the steward or trustee of that separate taxable entity, the corporation, he is interested in taxes on industry; their effect on the supply of corporate working capital, capacity for expansion and ability to pay dividends to the owners. His interest is not confined to Federal taxes although they absorb almost 25 per cent of the national income. He has become more and more aware of the growing significance of the swelling State and local tax "take"—which is now an unprecedented 7 per cent of national income. Thus, to the corporate executive of today, the term "tax structure" connotes the hodgepodge of *all* taxes, direct and indirect, levied on all types of entities in the United States by the thousands of taxing jurisdictions.

Management's interest is not confined to "ivory tower" observations. It is not purely on a social or philosophical level. The executive perceives the broad economic effects of a burdensome and near-confiscatory tax structure, it is true. However, he has a more initimate interest too. His day-to-day business routine is often complicated by tax cases of the irritating, carking, or illiberal type, and his major business decisions are circumscribed by more serious tax impedimenta.

Few of business's tax problems are new. Most of them originated steadily over a long period of time, growing in importance as rates rose, and mounting in profusion and complexity as their cumulative burden increased. Few problems have dissolved; although the solution of many appears to be in prospect by reason of the understanding and sympathetic attitude of the present administration.

Let us first discuss a few of the minor types of problems and their possible solution; then some of the major problems—those which tend to affect major business decisions; and finally, the effect of taxes on capital and individual incentive.

Minor Tax Irritants

Depreciation: Although minor in tax effect, one of the most harassing problems that has confronted taxpayers for the past twenty years has been the question of depreciation allowances. The Code provision granting a "reasonable" allowance for the exhaustion, wear and tear of property used in the trade or business, has probably prompted more and hotter disputes between taxpayers and the Bureau of Internal Revenue than any other one question. The reason therefore is that corporate officers and accountants who are responsible for the accuracy of business tax returns and the reasonableness of deductions claimed therein, generally feel that the amount of depreciation for which deduction was claimed in a particular year, having been determined to the best of their technical ability and knowledge in the light of conditions existing in the taxable year, should not be disturbed three or four years later by revenue agents armed with the experience of the intervening years.

Everyone knows that at best depreciation is an informed guess, not a scientifically determinable actuality; that there is no reason to believe that the agent's determination is any more accurate than the taxpayer's, and that, in the long run, the amount of depreciation claimed and allowed in a particular taxable year does not make any real difference in the national revenues since taxpayers are ultimately entitled to recover their costs, and once having done so are entitled to no further deduction.

On the other hand, the primary function of the Bureau of Internal Revenue is to protect the revenues. From its broad and long experience, coupled with its valuation and statistical studies, it has felt that taxpayers generally are inclined to charge off assets through depreciation too fast. Knowing that the burden of proving the reasonableness of the depreciation deduction rested with the taxpayer, the Bureau in the past has concluded that the quickest and easiest way to evoke that proof was to propose to disallow depreciation claims, whether by the reduction of rates or otherwise. Thus taxpayer-Bureau disputes and consequent irritation of the former have been very prevalent—to say the least.

This problem is the *first* one on which action has been announced by the Commissioner of Internal Revenue, himself a former practicing accountant. On May 11, 1953, Mr. Andrews promulgated a new policy of the Internal Revenue Service not to disturb depreciation deductions generally; and to propose depreciation adjustments only where there is a clear and convincing basis for a change. Among the criteria to be considered by Bureau personnel is the question of whether the taxpayer has followed a consistent practice in computing depreciation.

While there is not much change in the written policy of the Bureau from that previously avowed, it is believed that the Administration will be more sympathetic and less captious, thus modifying a minor but truly irritating administrative policy.

Divergence Between Taxable Income and Financial Income: Another phase of the Internal Revenue laws that creates taxpayer-irritation out of all proportion to its revenue importance is the divergence between taxable income, and income determined by reference to accepted accounting principles. Despite Code Section 41 which provides that taxable income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpaper, there have developed more and more exceptions to the rule. These accounting differences arise because the courts, or the Bureau of Internal Revenue and accountants simply cannot agree upon the correct treatment of some items of income or expense in determining taxable net income.

For example, rentals received by a lessor for the future long-term use of his property by the lessee are not true economic income until the service has been rendered, i.e., the use of the property furnished the lessee. Thus proper accounting would dictate treating as deferred income, the portion of advance rentals received applicable to subsequent years. The reasons for deferral are two: (1) the income, even though reduced to possession, cannot be deemed earned until the "service," i.e., the use of the property, has been furnished; and (2) the income should be related to the years when the offsetting expenses (e.g., depreciation) are incurred.

To show a profit by treating, say, five-years' advance rentals as income in the first year of a lease and a loss every year thereafter by reason of the expenses applicable to such years, finds support in neither accounting logic nor good sense. Yet the Courts have so held under the "claim of right" doctrine.[1] There is no quarrel with the doctrine here but rather with its application to such items as advance rentals,[2] prepaid insurance commissions,[3] advertising,[4] health services,[5] and motor services.[6]

To avoid the inequity of paying taxes on unearned income in the year of receipt, management finds itself expending otherwise valuable time and energy searching for methods of avoiding the inequitable tax impact and still attaining the desired economic effects. Escrow funds and similar complicated devices are resorted to, for the purpose of averting the payment of tax that should not obtain in the first place.

[1] *North American Oil Consolidated v. Burnet,* 286 U.S. 417.
[2] *Schultz,* 44 B.T.A. 146, etc.
[3] *Brown v. Helvering,* 291 U.S. 193.
[4] *Elliott Co.,* 45 B.T.A. 82.
[5] *Your Health Club,* 4 T.C. 385.
[6] *South Tacoma Motor Co.,* 3 T.C. 411.

Another example of divergence between taxable income and financial income is the possibility that under existing law, income tax may sometimes be imposed on transactions that are inherently and fundamentally capital in nature.

Few accountants admit that the sale by a corporation of its own stock can create income as such. This, because the stock of a corporation is considered inviolate as a source of capital, and all cash received from its sale simply is an addition to capital; the sale cannot be said to affect income—even if the stock sold is previously acquired Treasury stock. Yet, the Treasury since 1934 has maintained that taxable gain arises from the sale of Treasury stock by a corporation, if it "deals in its own shares as it might in the shares of another corporation."[7] What is more, the Treasury's contention has been accepted by the Courts.[8] The result is that to avoid the inequity of paying taxes on what are in fact additions to corporate capital, management invariably finds itself expending otherwise valuable time and effort in carefully arranging to retire all reacquired stock, so that subsequent sales of stock will represent, not the resale of Treasury stock, but rather the issuance of new shares. Only by such necessarily artificial means is the avoidance of an artificial taxable gain assured.

This type of problem is not without hope of solution. Congressman Daniel A. Reed, Chairman of the House Ways and Means Committee, recently made the following statement, to the members of the American Institute of Accountants Committee on Taxation:

> "One of the most important contributions which could be made towards income tax simplification would be to require reporting for income tax purposes to conform to established business methods of reporting income . . . I have heard the suggestion made that it would be helpful if accounting groups could prepare a code of recognized accounting principles and methods of accounting. If this were done, it might be easier for a taxpayer to compute his income tax in accordance with sound accounting principles and methods."

Following Mr. Reed's suggestion, a special committee to establish sound accounting principles for income tax purposes was appointed by AIA President, J. A. Phillips, to study the various areas of divergence between taxable income and financial income. The new committee plans to release its code of principles by the Fall of 1953, at which time Congressman Reed has indicated he hopes to have prepared legislation looking to a general revision of the income tax law.

[7] Sec. 29.22(a)—15, Reg. 111.
[8] *Com'r v. Woods Machine Co.*, 57 F. (2d) 635; cert den. 287 U.S. 613, etc.

It is thus apparent that some of the minor tax irritants to management are in the process of alleviation by a sympathetic administration and Congress.

Major Tax-Induced Problems

Probably the most frustrating aspects of taxation from a management viewpoint are those features of the substantive tax law and administrative policy that are economically unrealistic or needlessly arbitrary, or that tend to deter, impede or throttle otherwise desirable business transactions. Other features of the law tend to promote different improvident transactions solely for tax benefits inherent therein. Some of these features result from actions by Congress, others by the Courts, and still others are the result of too-strict, or arbitrary administrative policy. Whatever their origin, these aspects of the law create additional management problems, demand increasing management attention, and dissipate more and more management energy. Let us examine a few of them.

Purchase and Sale of Corporate Assets: Because of the difficulty of accumulating large personal estates from ordinary income under today's existing high tax rates, there is an understandable increase in attempts to convert ordinary income into the more favorably treated capital gains. Thus, many businesses that have been built up by their owners over a period of years, are now for sale for the reason that the owner hopes to realize from their sale, substantial cash funds at the low capital gains rates of 26 per cent. Indeed the acceleration of sales of existing business also has been provoked in large part by the forced liqiudation of stockholdings in close corporations by estates of their owners to pay estate taxes—other assets often being lacking in such estates. Thus, closely-owned corporations are being sold to larger corporations in increasing numbers. However, there *are* tax problems in effecting such deals.

The tax preferences of the seller and buyer rarely coincide. Assume that a sole stockholder of a close corporation has certain tax-induced preferences. He wants either: (1) the nonrecognition of gain or a single capital gain, or (2) an ordinary (deductible) loss. In these days of deflation of the dollar, the latter is rare. In most instances a gain is involved.

The buyer prefers: (1) a maximum basis for depreciation or gain or loss for assets acquired, (2) quickly amortizable or depreciable assets, and (3) the preservation of any operating loss, or unused excess profits carry-overs.

The issuance of the buyer's voting stock for stock of the "selling" corporation usually will result in nonrecognition of gain to the selling stockholders. It also will preserve an operating loss carry-over or unused excess profits credit of the selling corporation for application against future income earned by *that* corporation. However, such a transaction will not permit a "stepped-up" basis of the selling corporation's assets. Thus, generally the buyer wants to buy assets to obtain a stepped-up asset basis. The seller usually wants to sell his stock. A problem is always one of satisfying both parties so that the deal can be completed. However, the various provisions of the Internal Revenue Code, as they have been interpreted by the Bureau of Internal Revenue, have been an impediment to the complete satisfaction of both parties to such a transaction.

Since the buyer-corporation wants to buy assets, (they are generally appreciated in value over their tax basis to the existing owner) it would like to pay the selling corporation cash or the equivalent for such assets, so that their basis may be stepped up in the buyer's hands for future depreciation, or gain or loss. However, the purchase of such assets from the "selling" corporation usually will result in capital gain to the corporation, which, in turn, is followed by a second capital gain to the stockholder-owner upon its liquidation, and the receipt of its funds by him. Unless the corporation has offsetting capital losses or an operating loss, a selling stockholder will demur. He wants to sell stock and realize but one capital gain.

The buyer does not want to buy stock, because upon liquidation of the acquired corporation under Code Section 112(b) (6) the lower basis of the assets in the hands of the selling corporation will carry over to the buyer. At that stage begins the head-scratching and consideration of many alternatives and devices, most of which are discarded as being hazardous, taxwise.

The first idea is usually a suggestion that the selling corporation liquidate by transferring its assets to its sole stockholder, who at that stage would incur a single capital gains tax. The stockholder is *then* to enter into an agreement of sale of the assets to the buying corporation.

The buying corporation thus would realize its desired cost basis for the assets. The nonliability of the "selling" corporation for capital gains tax is grounded upon a finding of the Supreme Court in a recent decision which tended to modify to a certain extent an earlier decision. In the earlier decision[9] the selling corporation was deemed to be the true seller of assets and a tax was imposed upon constructive gain to it, even though

[9] *Court Holding Co. v. Com'r.* 324 U.S. 331.

the form of the transaction was a liquidation followed by the sale of assets by the stockholder. The recent decision[10] softened the application of the role, by holding that where negotiations for the sale are carried on and the sale is clearly effectuated by the stockholder, there is no constructive gain to the "selling" corporation.

Notwithstanding the clarity of the more recent Supreme Court decision, the perfection of such an arrangement and complete assurance of avoidance of the double capital gains tax is deemed difficult, and the seller's tax advisor often will steer him off that type of arrangement. Thus another method is looked for.

Sometimes the other method involves a partial liquidation of the selling corporation, whether before or after the sale. In either event, tax advisors become leary of possible exposure to Code Section 115(g) which would treat as an ordinary dividend, any distribution in partial liquidation, which is the equivalent of an ordinary dividend.

Because the Treasury has tended to invoke that provision in *almost every* partial liquidation, tax men hesitate to expose any taxpayer to its possible impact. Indeed that section is one of the most *overused* "Swords of Damocles" in the Internal Revenue Code. Certainly it either should be modified to limit its applicability, or administrative policy with reference to its application should be relaxed. The section obviously was not intended to apply to *every* partial liquidation; but such has almost become the Treasury's policy. Thus, this plan usually ends up in the discard.

If the buyer wants the property badly enough, the "desperation alternative" is often resorted to, in which it is the buyer who takes all the tax chances; that is, the purchase of all of the stock of the selling corporation from its sole stockholder, followed by its immediate liquidation. Under several earlier court decisions,[11] and one very recent decision,[12] the purchase is deemed to be a purchase of assets since the acquisition of the stock is followed in an integrated transaction by an immediate liquidation. Thus, held the court, the liquidation is not a tax-free liquidation under Section 112(b)(6), because the purchaser is deemed to have bought assets, and therefore is entitled to a cost basis for the assets rather than a carry-over basis from the selling corporation.

This particular type of transaction is so prevalent and the gyrations and manipulations of buyers and sellers so profuse, that it is a major

[10] *U.S. v. Cumberland Public Service Co.*, 338 U.S. 451.
[11] *Com'r. v. Ashland Oil & Refining Co.*, 99 F.(2d)588; cert. den. 306 U.S. 661, etc.
[12] *Kimbell-Diamond Milling Co.*, 14 T.C. 74, aff'd. 187 F.(2d)718, cert. den, 10-5-51.

area of frustration to corporate management. The provisions of the tax law simply serve as an impediment to what should be a very normal, easily effected business transaction.

Effect of the Excess Profits Tax Law on Business Decisions: The excess profits tax law has had a tremendous effect upon business decisions. The law is due to expire on June 30, 1953, but, as of the date of this paper, appears possible of re-enactment to December 31, 1953. Should relations between the United States and foreign countries devolve into open warfare within the next few years, the continuation of the excess profits tax for an even longer period of time is not unlikely. Therefore, the problems that it presents and the impediments that it furnishes are not necessarily of academic interest only—indeed that tax act is the *best* illustration of some of the abnormal effects of our tax structure. Here are some examples:

The payment of dividends has an effect upon excess profits tax liability. In general, *any* dividend will *tend* to reduce the excess profits credit in subsequent years. For example, a $1,000,000 dividend conceivably could constitute a capital reduction, or a reduction of a capital addition, which, at 12 per cent would reduce the excess profits credit by $120,000, and conceivably increase the annual excess profits tax by $36,000. Therefore, because an annual increase in excess profits tax of 3.6 per cent of the dividend indeed has been worthy of consideration, the decision to make dividend payments, and establishing the amount thereof has been a more difficult problem for management during excess profits tax years.

The Excess Profits Tax Act has had an important effect upon the nature of new capital, that is, as to whether it be acquired through the issuance of stock or through the incurrence of debt. The latter, in most instances, constitutes borrowed capital,[13] the incurrence of which in many instances actually produces a net *gain* to the issuing corporation. For example, taking interest payments into account and assuming that a corporation is in the 82 per cent tax bracket, the issuance of $1,000,000 of bonds at 4 per cent could produce a net *gain* of $10,800, i.e., the decrease in tax liability would exceed the interest payment by such amount. The issuance of a like amount of 4 per cent preferred stock, however, would result in a loss of $4,000 to the company, i.e., the tax benefits would be $4,000 less than the dividend payment required. According to the National Industrial Conference Board, many companies that ordinarily

[13] Under Code Section 439.

would be issuing stock to obtain new capital, have resorted to borrowings—certainly an unnatural condition.

In the acquisition of another business by a corporation, certain provisions of the excess profits tax law sometimes govern management's actions. For example, as is hereinbefore stated, the purchase of the business assets of another corporation for voting stock, or in any other type of tax-free transaction, will preserve the base period experience of the selling corporation for use by the purchaser.[14] It will also preserve the invested capital base of the selling corporation for use by the purchaser.[15] On the other hand, while the purchase of the assets of another corporation for cash also will, (if Part IV is applicable) preserve the base period experience of the seller under certain conditions for use by the buyer.[16] it will not preserve the invested capital base. Therefore, where the consideration paid exceeds the invested capital of the seller it is often found more beneficial to use the cash method of purchase, rather than the issuance of voting stock, thus reflecting the presence of "positive goodwill" in the invested capital of the purchaser. In any event, difficult decisions must be made with the tax law primarily in mind.

According to a National Industrial Conference Board survey of the effects of the Excess Profits Tax Law on business decisions, it is evident that the law's existence has tended to deter the consummation of many legitimate and otherwise desirable changes in the *form* of doing business. For example, a merger otherwise desirable from a cost savings viewpoint, or for some other good business reason, may have been deferred because the merged company is itself entitled to use a large, special type of excess profits credit which would be lost upon the merger; or because it may have an unused excess profits credit carry-over which similarly may be unavailable to the surviving company in a merger.

On the other hand, the excess profits tax law has tended in some cases to *encourage* changes in form of an existing business, where a lower excess profits tax liability would ensue therefrom.

There are many legal deterrents to obtaining tax advantages by means of reshuffling or rearranging the form of a business, notably Code Sections 15(c), 45 and 129, and the *Gregory* and *Smith* Doctrines.[17] These deterrents most certainly make hazardous any sham transaction or form adopted solely for tax purposes. However, there are some changes in

[14] Part II—Code Sections 461-465.
[15] Part III—Code Sections 470 and 472.
[16] Part IV—Code Section 474.
[17] *Gregory v. Helvering*, 293, U.S. 465; *Higgins v. Smith*, 308 U.S. 473.

corporate or intercorporate structure that have been found advantageous from an excess profits tax viewpoint, and yet are sufficiently realistic and justifiable from a business or economic viewpoint, to warrant the assurance of the more favorable tax treatment. For example, from an excess profits tax viewpoint it has been found advantageous to liquidate the wholly-owned subsidiary of a parent company, where the parent paid a substantial premium for the subsidiary's stock. Under such circumstances the "goodwill" reflected by the excess of the parent's cost of the stock over the tax basis of the subsidiary's net assets can be included in the parent's invested capital. This condition has precipitated many liquidations that otherwise might not have occurred.

Also, because income of nonresident foreign corporations is not subject to excess profits tax, it has been found advantageous for many corporations maintaining manufacturing and selling branches in foreign countries to create new foreign subsidiaries by the separate incorporation of the foreign branches. Thus, the income of the foreign "branches" is exempt from excess profits tax, and when collected in the form of dividends, often gives rise to a foreign tax credit to the parent company. There has been a tremendous "wave" of incorporation of foreign branches during the past several years—incorporations that otherwise might not have occurred.

As to the acquisition by a profitable corporation, of a corporation possessing a net operating loss or a large excess profits credit based on earnings, it would seem that Code Section 129 would indeed deter the use of the acquired company's loss or credit by the acquiring company. The reverse was approved in a case in which a company having a poor earnings history and a current operating loss, was permitted to apply such loss to reduce the income derived from a newly-acquired profitable business,[18] because there was present a good business reason for the acquisition, and there was no artificiality attached to the transaction. However, that decision has prompted many acquisitions of loss companies for tax purposes. Indeed quite a market for such companies has been established. It is said that the asking price of such a company is now 10 per cent of the potential loss!

The amount of time consumed by management in ferreting out the multiple tax effects of most of these transactions has increased tremendously during the past decade. The lapse of the excess profits tax would remove many of the tax-generated problems. A relaxing of the Treasury's attitude

[18] *Alprose Watch Corp.,* 11 T.C. 240.

concerning the applicability of income tax penalty provisions (e.g. Section 115 (g)) to areas where they were not originally intended to apply, would permit business greater freedom, and management fewer problems. That the present administration (both the Treasury and Congress) may be thinking in such terms is indicated by the encouraging expressions of cooperation between government and business. Perhaps the time will come when the tax-induced, carking and illiberal cares of management will be greatly diminished!

A LONG-RANGE TAX PROGRAM FOR THE FEDERAL GOVERNMENT

By J. A. Phillips
President, The American Institute of Accountants; J. A. Phillips, Sheffield & Company, Houston, Texas

It is a privilege for me to be here and to attend the Ohio Institute on Accounting as a representative of the American Institute of Accountants, which I have the honor to serve now as President. The topic of my talk this morning is a long-range tax program for the federal government. You are all well aware of the fact that the present national administration emphasized during its campaign last fall the need for drastic fiscal reform in our federal government. The tax program for our country is really only one side of the coin, the other side being the budget situation.

The monumental difficulty of developing a tax program which will not stifle initiative and enterprise, but at the same time produce sufficient revenue to run the diversified activities of our government and meet the tremendous budget requirements, was dramatically illustrated in recent weeks by the controversy between the President and Congressman Reed, the chairman of the Ways and Means Committee of the House of Representatives. The Administration was embarrassed by the fact that it promised in its campaign early reduction in tax rates. It had also indicated that there would be cuts made in the federal budget. The difficulty is compounded by the fact that the only logical way to approach the problem of tax reform is to undertake a comprehensive review of the entire federal tax picture. Only after such a study would it be possible to prescribe intelligently the kind of long-range tax program that our country will need for it to prosper and flourish in the years ahead.

The new administration already has recognized in a number of ways the need for a careful study of our entire federal tax picture. We, as accountants, probably know better than any other group the fantastic structure that our federal tax law has become. It began as a relatively simple law early in the century, and over a very short space of years it has become so complex, and so incomprehensible in many areas, that tax practitioners find it necessary to spend an inordinate amount of time studying the current changes in legislation and court interpretations in order to provide their clients with competent and up to date counsel. The tax law is filled with inequities. As one pressure group succeeds in achieving a more favorable position tax-wise, another seeks special privileges of its own, with the result that the law is filled with inconsistencies and preferred treatment for special groups.

Our system of taxation is fundamentally one of self assessment. If we should ever reach the position that exists in many European countries where tax evasion becomes rampant and public trust in the revenue collectors is lost, we will have to scrap our present system. I think we came perilously close to that situation in the past few years. Fortunately, quick steps were taken to wipe out corruption and only a bad memory remains which I am confident will be dissipated as the results of the changes made by the new administration become evident.

The appointment of Commissioner T. Coleman Andrews, a former president of the American Institute of Accountants, and a splendid administrator, indicates the tremendous importance in the eyes of the new administration of the Bureau of Internal Revenue and its proper and efficient management. It seems to me that the restoration of public confidence in the impartiality of the Bureau of Internal Revenue in the collection of taxes will provide a necessary background to the development of a well integrated, equitable, long-range system of federal taxation.

Secretary Humphrey of the Treasury Department has already announced that his department is studying our entire federal tax system. Recently the appointment of Professor Dan Throop Smith of the Harvard Business School was announced. Professor Smith will act as an adviser-consultant to the Secretary. His long experience in the field of taxation promises to afford the Treasury Department an incisive study of taxation, and the probable introduction of methods and distribution of taxation that will yield the necessary revenue with minimum disturbance to our economy.

President Eisenhower established a bipartisan commission recently to recommend laws to eliminate the hodge-podge duplication and waste in taxation and other fields shared by the federal, state and local governments. This commission will have some members designated by the President, the Congress, and the Conference of State Governors. It is expected to begin work soon, and appropriate legislation has already been introduced in Congress by Senator Taft.

The Staff of the Joint Committee on Internal Revenue Taxation has been engaged during the past several months in an analysis of our existing federal tax laws. Last October, Colin Stam, Chief of Staff, circulated a questionnaire in which he invited suggestions and recommendations leading to the improvement of the federal tax laws and their administration. Literally hundreds of replies have been received covering all phases of federal taxation. It is expected that an analysis of these replies will form the basis of the recommendations for tax modification by the Ways and Means Committee within the next year.

In addition, many professional societies and other organizations regularly submit recommendations upon specified aspects of federal taxation. The committee on federal taxation of the American Institute of Accountants, the section of taxation of the American Bar Association, the National Association of Cost Accountants, the National Association of Manufacturers, the United States Chamber of Commerce, and many other organizations, are continually engaged in a study of the tax system and make recommendations about it.

However, from the very inception of federal taxation no effort has ever been made to plan a federal tax structure in conformity with the long-range needs for revenue of the government. Instead, a patch-work approach has been used by which the code has been amended to suit the exigencies of revenue needs, and the ability of the various economic groups involved to resist having their relative tax-load increased. Even now, the simple, and in most cases, the most feasible political technique for tax revision is to provide for some percentage over-the-board increase, or decrease. Obviously such an approach does not provide the kind of cure that is necessary. An across-the-board change merely solidifies the inequities that have been injected into the code over a long period of years.

Although the Institute encourages the attitude which is at the bottom of the formation of these various groups which are endeavoring to study our tax system, it believes now, and has for a great many years, that the most desirable way to accomplish long-range tax revision is through the formation of a non-partisan tax commission which will be charged with the responsibility for carefully analyzing the existing tax structure, and recommending appropriate changes. Such a commission would be composed of members of Congress, certified public accountants, lawyers, economists, and representatives of the public. Provided with sufficient funds and an adequate staff, the commission over a two-year period—possibly more—should be able to do the necessary job effectively. Moreover, the appointment of such a commission should earn the support of all of the organizations and government agencies which are at the present time engaged in tax study. Their efforts would and should be directed to assisting such a non-partisan tax commission.

I wish to call attention at this moment to the fine work that is being done by the American Law Institute which for a number of years, with the help of a grant from the Maurice & Laura Falk Foundation of

Pittsburgh, has been engaged in an endeavor to recodify the Internal Revenue Code. The American Institute of Accountants has been happy to cooperate with the American Law Institute in this effort, and a number of meetings have been held, attended by representatives of both organizations. This work of the American Law Institute will be extremely valuable, and the many years of efforts that they have exerted in their program will be extremely valuable background for the program of a nonpartisan tax commission.

The American Institute of Accountants is at the present time engaged in a study which should result in the enumeration of the many instances in the Internal Revenue Code where accounting for tax purposes does not conform to generally accepted accounting principles. That situation has been deplored for many years and recently Congressman Reed of the Ways and Means Committee requested that the Institute embark on this study. The work is already under way. It is hoped that by early next fall the report will be completed. Studies of this kind are extremely valuable but still limited in scope. Beyond this, there is need for some careful and objective thought dedicated to the production of an over-all tax system which will suit the needs of this nation today, and for the foreseeable future.

The committee on federal taxation of the American Institute has for a number of years dedicated itself to the development of such a long-range tax program. Accordingly, it has formed a sub-committee on long-range tax policy. This subcommittee has been intensively studying the following topics with a view to producing recommendations for their long-range treatment; Averaging of Income, Corporate Taxation, Family Taxation, Charitable Foundations and Organizations Exempt from Tax, Capital Gains and Losses, Emergency and War Taxation, Miscellaneous Taxes, Depreciation, Partnerships, and the Integration of Estate, Gift and Income Taxes.

Three of these ten topics have already been studied to the extent that papers containing tentative conclusions and recommendations have been published in issues of *The Journal of Accountancy* during 1952. Study continues on the other topics, and it is hoped that several more reports will be completed during the next few months.

I felt that you would be interested in knowing about some of the questions encountered by the sub-committee in its study of the three projects which are relatively well advanced, namely the Averaging of Income, Corporate Taxation and Family Taxation.

The first topic I would like to consider involves the work of the subcommittee in trying to determine whether a method of Averaging of

Income would provide a feasible basis for federal taxation. Many problems arise today because of the fact that we have progressive taxation, and income is taxed on an annual basis. An irregular income can produce a completely different tax from equal amounts of income earned constantly during the same total period of time. For example, using 1952 rates, a married individual without dependents filing a joint return based on a $4,000 income in one year pays a total tax that is 75 per cent greater than another taxpayer who earns $2,000 in each of 2 years. If the individual has net income before exemptions, of $7,000, his tax is about 30 per cent greater, when the income is realized in one year as opposed to its realization during two consecutive years. Moreover, if the net income before exemptions is $25,000 a year for two years, the total tax is 46 per cent more when the $50,000 is earned in one year. Now, I grant you that the system of progressive taxation we have adopted in this nation is a vital part of our code, but it does seem inequitable that two individuals should be taxed so differently for exactly the same amount of income merely because of the timing of its receipt.

Professional men of course are particularly subject to this inequity. Doctors, lawyers, certified public accountants, and other professionals must undergo long periods of training and apprenticeship during which time their incomes are low, before they are privileged to enjoy higher earnings for a relatively short period of time. Then, of course, their tax bill is prohibitively high. The unfortunate result is that such persons find it very difficult, if not impossible, to save sufficient funds to provide for their old age. That problem is receiving careful consideration now, and it is conceivable that legislation will become law in the near future which will provide tax incentives to professional persons and certain other taxpayers, to enable them to provide more adequately for their retirement.

Perhaps, the entire problem of irregular income would be better solved under some approach by which an averaging technique were adopted. Mr. John S. Cowing of Philadelphia, a member of the subcommittee on long-range tax policy, has studied this problem for several years, and he has reached some tentative conclusions. The problems encountered in taxing capital gains also would be eased under the adoption of an averaging technique. Capital gains tax treatment has varied widely during the course of the years, but generally speaking, those gains have received special tax treatment and are taxed at lower rates than earned income. Probably, the rationalization for that special treatment arises because it is not considered fair to tax realized gains at regular rates in the year of their receipt by the taxpayer, since the gains were probably developed over a long period of time. The supporters of averaging of income feel special treatment of capital gains would not be necessary if their plan were adopted, for such gains would be thrown in with all other income received in the computations of average income for any one year.

Averaging of income is not unique. It is in use today in Australia, was used for many years in Great Britain, and even this country has some experience, although short. Wisconsin enacted some averaging technique in the late 20's, but the method was ended in 1932 because it was difficult to collect sufficient revenues during the depression. It must be admitted that the experiences with averaging to date have not been entirely favorable. There are difficult problems of administration—some consider them to be insuperable—but certainly the subject deserves consideration today.

Although it would be possible to use a simple average, and a moving average, the method that seems to have earned the greatest amount of support is the so-called progressive average, which is the actual average of the income of the year of assessment, and of all the preceding years of the averaging period. The average is obtained by adding the income of the current year to the income of all the preceding years in the period, and dividing the total by the number of years in the period. The tax could be computed by applying the current tax schedule to the current years average income. Some have suggested that the Treasury Department could furnish a simple schedule in each return to enable individuals to calculate their tax or refund under the proposed averaging method. I will not got into the details of the computation. I will endeavor to suggest to you some of the disadvantages that have been advanced in opposition to the method. For one thing, the tremendous problem that would arise in the transition period from the annual method of taxation to the averaging method, would have to be solved. The pressure on timing would be enormous. Capital losses sustained before the averaging method would have very limited significance compared with a capital loss in the first year of averaging.

The proponents of the averaging method argue that all of the present complicated provisions which are now geared to the question of time, such as carry-forwards, carry-backs, net operating losses, etc., would not be necessary if averaging were adopted. Another problem that arises in the case of the taxpayer who has a large capital loss during the first year of averaging, is whether he is to be excused from income tax until he has enough income to offset the large loss. Also, will the averaging system be optional? If it is, if the taxpayer is privileged to go at will, or even with the approval of the Commissioner, to an averaging method and back again to an annual method, will not all of the existing provisions in the code dealing with a year-to-year approach, including the treatment of capital gains have to be retained? Such provisions include net capital loss carry-overs; reporting of income from personal services ratably over a thirty-six month period or more; the back pay provisions of Section 107, which allow certain receipts to be taxed as if they had been received in prior years; and the installment sale method.

The sub-committee has not come to any final conclusion regarding the use of averaging of income. It does feel that the method has definite possibilities, and it is carefully considering this section as one possible way of simplifying the Internal Revenue Code, and making it more equitable. Mr. Cowing discusses these averaging techniques fully in two articles in *The Journal of Accountancy* which appeared in the January and November 1952 issues.

The second topic I will consider today is corporate taxation. Walter Bury of Detroit has considered that question with specific emphasis upon the elimination of the double taxation of corporate income, and his paper was published in the July, 1952, issue of *The Journal of Accountancy*.

The 1913 Revenue Act which established the basic principles of the present federal income tax law, imposed a 1 per cent tax on corporate income, but exempted dividends from the 1 per cent individual normal tax. Individuals were also subjected to a surtax with a starting rate of 1 per cent on surtax net income greater than $20,000; but since the rate of the corporate tax and the individual normal tax was the same, and dividends were exempt from the individual normal tax, corporate income was subjected to only a single tax and the corporate income tax was in effect a withholding tax. However, later revenue acts changed the relationship of corporate and individual tax rates, so that the precedent established by the 1913 act of taxing corporate income at a rate equal to individual normal tax rate did not continue throughout the period during which dividends were exempt from the individual normal tax. The last step in establishing double taxation of dividends took place when the Revenue Act of 1936 was enacted, which repealed the dividends received credit for individual stockholders. The result today is the double taxation of corporate income, which even becomes multitple taxation where inter-corporate stockholding and parent and subsidiary corporations are involved.

This inequity has had far-reaching consequences, and has certainly influenced the methods of organization for business activity. The desire to avoid this double taxation has resulted in unsound corporate financial structure, through the increased use of bond issues, the interest payments for which are deductible for tax purposes. More important, however, it is generally believed that the high corporate tax rates, together with virtually confiscatory individual rates in the higher brackets, have acted to discourage the investment of risk capital. The ultimate consequences of such a situation are obvious to all—it can only produce the stultification of industrial progress.

Mr. Bury believes that this inequity should be immediately corrected and possibly eliminated. One cure would be to eliminate the tax on intercorporate dividends, and to treat the tax on corporate income as a withholding tax, in a manner similar to the way in which the withholding tax on salaries and wages is regarded today. In the event that such a change would be deemed undesirable now, because of the immediate reduction of revenue that would result, then it is recommended that the tax on intercorporate dividends be eliminated, and that a credit be granted for dividends received by non-corporate shareholders equal to the initial combined rate of normal tax and surtax on individual incomes. Under this method, there would be no refund of tax in the event that the credit which would be based on the dividends received exceeded the personal tax liability.

It is impressive to note that England and Canada have recognized the inequity of doubly taxing corporate income. In Great Britain for many years the practice has been to treat the corporate income tax as a withholding tax at the source, and personal stockholders are granted credits for the income tax withheld and paid by the corporation. The stockholder included in his income the cash dividends he receives, as well as the tax paid on his behalf by the corporation. In the event the credit for the tax withheld is larger than the individual's tax, the overage is refunded.

The Canadian treatment is somewhat different. Since 1949, Canada has allowed individuals residing there a tax credit of 10 per cent of their net dividend income. However, unlike the English method, the net and not the gross dividend is made the measure of the individual tax, and no refunds are granted, even if the credit exceeds the personal tax. Starting in 1953, however, Canada is raising the credit so that it will be 20 per cent on dividend income, and this credit will be in excess of the initial individual rate for 1953.

Mr. Bury recommends another alternative to the problem of double taxation of corporate income, which would provide for the classification of corporations either as public or private corporations. Private corporations would be those which are closely held, and their income and losses would be prorated to their stockholders, who would be treated as partners. All other corporations would be taxed as public corporations. Obviously, it is not desirable to apply this partnership method to widely held corporations. For these corporations, the corporation would pay the tax on its income, and its stockholders would be allowed the credit against their individual tax as described above.

The adoption of methods such as these would succeed in eliminating one of the grossest inequities that exists in our tax law today. The benefits of such a revision are incalculable. However, I believe it should be obvious to all that during the immediate future, when the free-enterprise system under which our nation has prospered and grown is being put to severe test, it is essential that our government recognize in its tax structure the fundamental concepts that America will continue only if investment in new ideas and ventures is encouraged. Such exploration and the taking of industrial risks is unattractive with today's tax structure, and one of the most objectionable obstacles placed in the way of investment today is this double taxation of corporate income. It should be eliminated as soon as possible.

The last topic that I will specifically consider today concerns possible changes in our methods of taxing the family. Mr. Russell Bock of Los Angeles has been studying this topic for the sub-committee on long-range tax policy. His tentative conclusions have been published in the October, 1952, issue of *The Journal of Accountancy*. The family tax front has been relatively quiet since 1948, when income splitting was made available to the entire nation. However, Mr. Bock believes that there are still a number of inequities in our tax law regarding the treatment of the family, tax-wise. He suggests that possibly there is a discimination against single taxpayers.

The availability of income splitting has made the marriage state considerably more attractive than it used to be. For an individual with a net income of $10,000 before tax, the advantage of marriage amounts to $624; for individuals with incomes of $50,000 before taxes the advantage rises sharply to $6,586, and the individual with an income of $200,000 for the year, before tax, enjoys an advantage of over $20,000 in the event that he embraces marriage. (Under the 1952 rates.) At those rates, marriage becomes a business proposition. It is generally conceded that two cannot live as cheaply as one; some sociologists hold that two can live about as cheaply as one and one-half, and probably the proportion becomes more favorable with larger families. However, the experiment of marriage should be a voluntary one, and probably the tax structure is not the proper vehicle for encouraging marriages in our country.

At present under the 1952 rates a single person reaches the 90 per cent bracket at the $100,000 income level, whereas the same income for a married couple produces only a top rate of 77 per cent. At least for the higher brackets, it might be desirable to mitigate that inequity by enacting into the law similar tax rates for single taxpayers. Such a change would have little effect on the revenue but it would certainly be welcomed by all bachelors.

Now, there is probably discrimination against working couples. This is particularly true because of income splitting. Today, all couples have the advantage of income splitting whether the wife works or not, and the result is that the working wife is somewhat discriminated against. She surely has extra expenses in connection with the income that she earns, such as the cost of a baby-sitter or nurse, and possibly even the cost of a housekeeper or a maid.

This inequity has already been recognized, for there are several pieces of legislation introduced in Congress now—popularly referred to as Babysitter Amendments—which would enable married women to deduct at least part of the extra expenses which are necessary for them to work.

Mr. Bock also considers the discrimination against earned income. This is not a new problem. As a matter of fact, at one time the Internal Revenue Code did have provisions which taxed earned income on a somewhat different basis than unearned income. Today, particularly with the opportunities that exist to enable some taxpayers to reduce the impact of taxation on their unearned income by virtue of such devices as family partnerships, trusts, and the attributing of income to other members of the family, some compensating advantages would seem to be desirable for taxpayers who receive earned income.

One approach would be to steal a leaf from these partnership provisions, and allow taxpayers with earned income to attribute part of their income to their children. For example, a taxpayer with one child might attribute 10 per cent of his income to the child; then under the split income provisions his return would show income attributable to the extent of 45 per cent to himself, 45 per cent to his wife, and 10 per cent to the child. Such a change would produce a somewhat more equitable relationship between the taxation of earned and unearned income.

Mr. Bock has also considered the possibility of changing our approach to the granting of personal exemptions. In some respects, I suppose the basis upon which these exemptions are granted is most illogical. Taxpayers today get a $600 exemption for themselves, and $600 for each of their dependents. However, apparently no effort has been made to recognize that there are considerable differences in terms of the dependents for which taxpayers are entitled to these exemptions. For instance, the taxpayer with a child born on December 31 is entitled to a $600 exemption. The exemption does not increase through the years, even though surely the cost of raising that child varies; and that same taxpayer is allowed only a $600 exemption for his son 18 years later when he must assume the costly burden of sending him to college. Also, the requirements for the exemption of a dependent, under which the taxpayer must have contributed more than half the support, and the dependent must not have earned more than $599, produces sometimes illogical results. Suppose the dependent—a young college boy—earns $601 during his summer vacation. The taxpayer loses the exemption, although the amount of contribution to the boy's rearing could be at its peak. It seems that some basis should be worked out which will prorate the granting of exemptions, even when the income earned by the dependent is somewhat greater than the maximum. For example, it might be arranged so that the receipt by the dependent of $700 per year would mean that the taxpayer would receive only a $500 exemption; $800 of income of the dependent would give the taxpayer $400 exemption, and so forth.

Possibly the most amusing aspect of Mr. Bock's study concerns his analysis of the effect of income taxes, if any, upon family life. Although he did not reach any definite conclusions, I think you will agree that he caused a lot of smiles.

First, Mr. Bock attempted to determine whether or not the granting of income-splitting to all married taxpayers in 1948 affected divorce rates. Since income splitting is surely an attractive tax feature, Bock thought it might have caused a decline in the divorce rate. He has compared the average divorce rate for 1,000 persons for the years 1947-49 in the four community property states of California, Idaho, New Mexico, and Texas, where the change in income-splitting had little effect because they had it all the time, with the rate for the non-community property states. The base period is 1947 and the index number for that year is 100. In 1948, there was a substantial drop in divorce rates in community property states to 84, and in 1949 it dropped still farther to 79. However, in the non-community property states the divorce rate dropped more sharply to 81 in 1948 and dropped to 76 in 1949.

You may argue the difference is minute, and it cannot be definitely concluded that fewer people are getting divorces now, as a result of income-splitting. However, there does seem to be some slight statistical evidence to support the theory that some people would prefer to endure the tortures of incompatability, rather than to raise the amount of the taxes they pay each year to dear old Uncle Sam.

Since 1948, if a couple was married at any time during the year, even as late as December 31st, they would be entitled to the benefits of income-splitting. Accordingly, Bock wonders whether this tax change has affected the frequency of marriages in the month of December. In other words, he wonders how many swains succeeded in suppressing their ardor during the first ten or eleven months of the year and deferred or postponed their marriages until December. It sounds wonderful. The husband does not have to support his spouse until December, but the couple gets all of the benefits of income-splitting. Bock has found out that in 1946 and 1947, before the tax change, there were 122 marriages in the United States in December for every 100 in the following January. December has apparently always been a very popular month. However, in the two years following the change, there were 130 December marriages as compared with 100 in January. So again, it seems there is evidence to support the theory that some persons consult not only their hearts, but also their tax position in setting their wedding date.

Lastly, Mr. Bock has attempted to find out whether the change since 1944, under which taxpayers are entitled to a full year's dependency credit for children born even as late as December 31, has affected the timing of births. He has found out that in the period from 1940 to 1944, there were 96 births in December for every 100 in January. But after the change in the five years from 1945 to 1949, the number of births in December increased to 103 for every 100 in January. Now, I am a cautious man, and I would be the last one to draw the conclusion that the tax bill has any bearing whatever upon the begetting of an heir, but you will agree that the statistics support that suspicion.

At this point, I am reminded of the story that I heard about dependents. It was told by Jack Seidman, chairman for the sub-committee on long-range tax policy, and a well-known raconteur. His story concerns a maid in a household; she had worked there for many years and was evidently thoroughly satisfied with her salary and working conditions. However, one day she told her employer that she would have to leave. The lady of the house was thrown into a panic immediately, and recklessly offered to raise the maid's salary, give her a television set, and grant her all kinds of benefits. But the girl was adamant. Finally, she told the full story. She said: "Well, you see, I really have to leave because I'm going to have a baby." The lady of the house said, "Well, we do not have any children. You seem to be a nice kind of girl and suppose you have that baby and we will raise it for you, and you stay with us." At this time the next year exactly the same thing happened. Now, they had two children. The next year the same thing happened, and the fourth year the girl approached her mistress and again gave her intention of leaving. This went through the same routine, and the woman, although slightly astonished at this, said, "Well, if it is another baby, we will be glad to take it over." The maid said, "Oh, no, it is not that, you see I just cannot work for a family with three children."

Mr. Bock and the sub-committee on long-range tax policy have not sufficiently crystalized their thoughts so that they are able to offer a definite tax program regarding the taxing of the family. Their investigation of the topic has only revealed that there does seem to be ample opportunities for change in our tax law in this area, and I trust that my discussion of these three topics, which have been intensively studied by the sub-committee on long-range tax policy, has revealed opportunities for changes in approach regarding our basic forms of taxation.

It is inevitable that any comprehensive examination of our tax system will reveal literally hundreds of instances where we have allowed ourselves to be hidebound by tradition. Instead, a tax system should be logical. It should treat taxpayers fairly, and obviously, of course, it must be able to provide the amount of revenue that is needed to support the essential activities of our government. Taxes are always painful and unpleasant to pay. But if the taxpayer at least can be secure in the knowledge that the system under which he is required to make his payments has been contrived with a view to treating all taxpayers with equity, he will pay his bill more cheerfully.

Surely you will agree that the oppressive features of taxation today which discourage enterprise and the investment of risk capital, must be eliminated as quickly as possible. The Young Presidents' Organization recently issued a report in which they examined the effects of the excess profits tax on many young companies. In far too many instances, required expansion and the development of new products and services was not initiated because this excess profits tax confiscated the money necessary for these companies to grow.

Many students of taxation have felt that if the excess profits tax had been enacted in the early part of this century—at the time when possibly the greatest economic growth in this nation occurred—we never would have achieved our ability to produce and distribute goods to the extent that we know today. Many economists hold that we are still only on the threshold of our ultimate productive and distributive ability. What a tragedy it would be for our nation and the world if we never could reach our full stature because of a short-sighted tax policy. The kind of comprehensive tax study which I am advocating would endeavor to consider the impact of taxation upon the ability of our nation's industry to expand and to grow soundly. I request all of you to give heed to the Institute recommendation which calls for the establishment of a non-partisan tax commission.

If you feel that such a step is a useful one, let your congressional representatives know. The Institute is taking appropriate steps right now to be sure that all the reasons favoring this kind of study are made known to our representatives in Congress. Your help will be valuable.

I certainly appreciate your courtesy in listening to my chosen topic.

THIRD SESSION

THURSDAY, MAY 21, 1953—2:30 P.M.
Ohio Union—West Ballroom

Presiding:

J. B. HECKERT, *President, The National Association of Cost Accountants*

Paper: "Trends in Internal Auditing"

C. J. GHESQUIERE, *President, The Institute of Internal Auditors; Internal Auditor, The Detroit Edison Company, Detroit, Michigan*

Paper: "The Controller's Expanding Duties"

EDMUND L. GRIMES, *President, Controllers Institute of America; Executive Vice-President and Controller, Commercial Credit Company, Baltimore, Maryland*

TRENDS IN INTERNAL AUDITING

By C. J. Ghesquiere
President, The Institute of Internal Auditors;
Internal Auditor, The Detroit Edison Company, Detroit, Michigan

This title was chosen because there are many conflicting opinions about the role of the internal auditor. These conflicting opinions result from the many varied practices in different industries as well as the academic and theoretical opinions.

Probably the only authoritative reference available to indicate the responsibilities of internal auditors is the *Statement of Responsibilities of the Internal Auditor,* published by The Institute of Internal Auditors in 1947.

The statement published by the Institute was accepted and endorsed as a fair and considerate statement of the responsibilities of the internal auditor at its stage of development as of the publication date in 1947.

We all know that practices vary considerably in different industries and companies, and that practices will also change from year to year. I believe that internal auditing is a well developed, modern and expanding profession, and that therefore we should *expect* to see many changes occur. These changes will be in the area of general responsibilities as well as in detailed practices and procedures. Although internal auditing has been operating for many years, I believe that it has made its *greatest* progress in the last decade. I also feel that the activities of internal auditors through the Institute of Internal Auditors has played an important part in this development.

It is probably well for us occasionally to ponder over the general trend of internal auditing activities. In order to do some constructive thinking about this we need to know what other companies have done, and also to review the situations within our own companies. The recent survey of the membership of The Institute of Internal Auditors, of internal auditing practices in industry is the most current record available. This survey was conducted under the direction of the Committee on Internal Auditing Principles and Practices. A summary report is published in the Institute's publication, *Education and Service to Management.* This publication is the one covering the addresses presented at the 11th Annual Conference of the Institute in St. Louis. I will make frequent references to this survey which I will identify as the Institute survey.

When evaluating the trends in internal auditing, I like to observe the changes in our Company, namely The Detroit Edison Company. Because frequent references will be made to practices in our Company, I feel that you should have a brief statement about it.

1. We conduct principally an electric lighting and power business in Detroit and adjacent territory. The territory covers an area approximately within a radius of 100 miles of Detroit, and a population equivalent to one-half the State of Michigan.
2. We have a central general office, and seven Sales Department district offices. There are about 90 commercial offices, 35 warehouses, 5 power plants and numerous other properties.
3. We have 65,000 stockholders, 11,000 employees, over one million customers, and gross revenue of about $175 million.

Management

First, let us take a look at the trend with respect to the internal auditor's place in management. It is difficult to find any records of the internal auditing activities' place in the Company organization a decade or more ago. There appear to be very few written articles of consequence prior to the organization of The Institute of Internal Auditors in 1941.

The Institute survey of 1950-51 shows that the great majority of auditors report to senior officers, such as Chairman of the Board, President, Vice President, Controllers, and others. Approximately one-half report to the Controller or Assistant Controller. The Committee reports that the internal auditor should report to no less an officer than the one who has over-all financial control, and who does not supervise accounting functions directly.

The Edison Electric Institute and the American Gas Association Accounting Section conducted surveys of 23 public utilities in 1945, and 16 utilities in 1950. The 1945 survey indicated that the Auditing Department was a separate organization, and not a part of the Accounting Department in 14 of the 23 companies. It also showed that in 15 instances the Auditor reported directly to the Board, President, General Manager, or a Vice President, compared to only 6 reporting directly to a Controller or Chief Accountant. The 1950 survey showed 10 companies reporting to the President or Vice President, and 4 to the Controller.

Although there is no positive evidence to prove that the trend is definitely in the direction of internal auditing reporting directly to top management, and away from the accounting units, I feel certain that this is the case.

In Detroit Edison, prior to 1941, the Auditing Division was in the Accounting Department. The Board of Directors accepted our public accountant's recommendation to make it a separate organization reporting directly to the President and General Manager in December 1941. I will give you a brief story of the Auditor's place in our Company organization at the present time.

The Auditor is appointed by the Board of Directors annually. In addition to the elected officers, we have an Operating Council which is made up of the senior officers and operating heads of the Company—27 in all. It meets weekly to discuss matters of general importance. The Auditor is a member of this Council. The other Council members who have responsibilities in the accounting and financial area are as follows:

Secretary and General Accountant—has responsibility for all accounting records, financial statements, registration statements, cost records, taxes and other accounting service functions.

Vice President and Controller—has supervision and approval of operating and construction budgets; all cash commitments; rate studies; statistics; and relations with the State Public Service Commission.

Treasurer—performs such duties as generally pertain to the office of Treasurer, including banking and financing. He also has jurisdiction over disbursements; cash; securities; investments; insurance pay rolls; and stockholders' records and dividends.

General Auditor—in addition to internal auditing, has the responsibility for general Company procedures and methods activities.

He serves management in activities other than auditing and procedures as follows. I will mention these activities merely to indicate management responsibilities sometimes given to the Auditor.

1. He is a member of the Salary Board, which consists of 10 members representing all departments in the Company, under the chairmanship of the Executive Vice President. The Salary Board has over-all responsibility for our salary policy as it applies to trades and operating, office, supervisory and staff employees. This includes all employees except about 330 who are on the monthly pay roll. This responsibility includes our job evaluation program. The Auditor is a member of a Salary Board Subcommittee that evaluates all of the supervisory and staff employees.
2. He is a member of the Records Destruction Committee that has the responsibility of arranging for and approving destruction of old general Company records and the establishment of retention schedules.
3. He is chairman of the Procedures, Methods and Forms Committee, which has the responsibility for the policy and program of affecting improvements in office operations and procedures.
4. He is a member of two temporary committees. One of these committees is studying the utilization of land and vacant properties in the Company. The other committee is studying our overtime pay practices, with respect to exempt rated employees.

The role of the Auditor in The Detroit Edison Company is probably indicative of the trend in this area in other companies.

Scope of Audits

Next, I will discuss some of the more specific functions and operations of the internal auditing department. The 1950-51 Institute survey indicates a trend toward auditing activities outside the accounting and financial departments. Presently only about 50 per cent of the companies audit functions such as sales and purchasing. The survey indicates that 211 out of 270 companies are permitted to examine all records in all departments. This indicates that the Auditor has a wide range to operate in, but apparently many Auditors do not take enough responsibility in this area.

In Detroit Edison, we spend considerable time in departments other than the accounting and financial. We visit every department in the Company for the purpose of reviewing practices, policies and procedures with respect to pay rolls; employee proposal plan awards; use of Company and employee-owned automobiles on Company business; custody and use of tools, equipment and certain materials and supplies. We also spend considerable time reviewing compliance with policies and procedures in activities such as purchasing; sales; customer relations; real estate; and insurance. In my contacts with top management personnel, I have observed that they generally think that the Auditor *will* concern himself with many matters outside the accounting and financial departments.

Recently, we have made it a practice when visiting departments, especially operating departments outside the accounting, to discuss the need for auditing activities in their departments by their own personnel and also by the Auditor's. This procedure has the effect of establishing a better understanding of our joint responsibilities and of our methods.

I will give one example of where an audit brought to management's attention a matter that resulted in the sale of a sizeable piece of property. A few years ago we had a piece of property in the heart of the city of Detroit which was about a city block square. It was used for the purpose of receiving coal by rail and for temporary storage of coal hauled there from our coal docks. All of the coal was used for our Central Heating Stations. The property had mechanical facilities for unloading freight cars of coal, and conveying it for convenient loading into trucks for hauling to the heating plants. It cost the Company approximately $700,000, and the annual taxes and maintenance costs were in excess of $25,000. One of our auditors, while making an audit of coal inventories, observed that these plant facilities were seldom used for receipt of coal by rail, its primary purpose. It had become primarily a storage yard for coal received by boat and hauled there for temporary storage. This resulted in a very uneconomical use of this property, and it was later sold at a substantial loss. It was still a very profitable sale from the Company's standpoint because it reduced annual operating expense by at least $25,000 or more.

Audit Reports

The writing of audit reports is one of the important phases of internal auditing. Much has been written and told about audit reports. In general, I am sure that auditors have profited by the extensive discussion of reports, and our reports are showing considerable improvement in recent years. This applies to all types of reporting, written and oral.

The Institute survey showed that 242 out of 267 companies reported that at the conclusion of an audit examination, the auditors met with the representatives of the audited organization to discuss the findings prior to issuing the report. The survey also indicated that when individual audit reports are not regularly routed to the President, Vice President or similar executives, that about 50 per cent of the companies send periodic summaries of significant audit findings to these executives. It is to be expected that the form and content of reports will necessarily vary according to the purpose they serve and the authority and personality to whom they are addressed.

I would like to give you briefly our Detroit Edison experience and practices. We issue several kinds of reports.

1. We require each senior auditor responsible for the audit of a particular unit of work to write an audit report to the Auditor setting forth all of his findings, including the oral recommendations he made to operating personnel.
2. We expect senior auditors to write reports to department heads or others informing them of significant findings on units of work under their supervision at the conclusion of the audit.
3. We request supervising auditors responsible for continuous audits, such as warehouse inventories; commercial office audits; departmental payroll audits, etc., to write annual summary audit reports reporting the outstanding findings, changes in procedure or policies and general recommendations in such activities to the Auditor, and to the officer in charge of these activities.
4. During the last two years, the Auditor has issued an annual report of the Auditing Department's operations to about 12 senior officers, including the Chairman of the Board. This report is about 8 typewritten pages in length. It includes a statement of general auditing objectives, significant changes in our program from the preceding year, and outstanding findings and recommendations.

The mailing of this annual report to senior officers of the Auditing Department's activities is comparatively new in our Company, and is not done in most other companies. I have made some inquiries about this.

We have been issuing such an annual report for about twelve years, but until recently it was sent only to the President and to our outside auditors. The more extensive distribution of this report was at the request of the President, who I believe was embarking on a program of requesting annual reports from all major operating departments in the Company.

I had some serious misgivings about the wisdom of sending copies of our report to all senior officers, but decided to send them rather than to take issue with the President at the time of his request. After two years' experience, I have decided that we should return to our former arrangement of only sending copies to the President and to our outside auditors. We have a new President since our last report was issued, and I am quite sure that he will consent to this arrangement. There are some advantages in sending copies of our annual report to all senior officers, primarily in that they become better informed about internal auditing and its potential. However, I consider this is more than offset by the unfavorable reactions incurred as the result of making public the shortcomings of the departments. Some of the senior officers resent having the shortcomings of the departments under their jurisdiction presented in writing to other senior officers. I, personally, do not feel that we accomplish much good by doing this, and certainly do not recommend this procedure.

Department heads do not usually resent getting written reports, when they know that the reports are not sent to their supervisors. We prefer to do all of our reporting at this level or lower whenever possible. I feel rather strongly about correcting shortcomings disclosed by our auditors at the lowest level of supervision possible. It creates better relationships between our auditors and the personnel audited. We also feel that the end results are good.

Procedures

One of the most controversial activities is that concerning the preparation, review and audit of operating procedures. The trend of auditing responsibilities for procedures has probably been in the direction of more rapid changes than in most other auditing activities. The development of separate systems and procedures organizational units has accentuated the changes.

The Institute survey indicates that the internal auditor is permitted, or encouraged, to review or criticize procedures in almost all cases. Approximately 90 per cent of the companies report that they review procedures either through post-audits or through pre-release reviews. The survey also shows that 172 of 243 companies make reviews of procedures outside of the accounting and treasury departments. There are 187 companies, or 68 per cent, of those reporting that have separate systems and procedures organizations. In these companies, two-thirds of them indicate that the internal auditors comment upon and approve all newly developed or revised procedures prior to adoption.

If no separate system and procedures organization exists, the survey indicates, that in about one-half of the companies the internal auditors are primarily responsible for developing and installing new accounting, and related systems and procedures.

In Detroit Edison, we have a separate system and procedures organization. I will express my own views about the procedures activity, which will also portray the practices of our Company.

I feel that the development of procedures and revisions thereto should be the responsibility of the operating personnel in the various departments. Internal auditors should refrain from participating in this, except in a reviewing capacity. Many times it may be worthwhile to have the auditor review a new or revised procedure before it is made effective, rather than to appraise or criticize it at the time of audit. I repeat, though, that the personnel doing the work should take the responsibility for preparing and maintaining their own procedures. If outside assistance is required to give advice in this work, this should be furnished by the systems and procedures staff personnel. I have no serious objection to procedures staff personnel writing the procedures, providing that they work with, and have the complete acceptance of, the operating personnel.

The appraisals and reviews of procedures in terms of their adequacy and effectiveness is generally accepted as the responsibility of the internal auditor. Checking the extent of compliance with established procedures is also the auditor's responsibility. .However, it appears advisable for the procedures man to review the operation of new procedures which he has assisted in developing. This should usually be done after the procedure has been in operation long enough to have had a reasonably good trial. After the trial, or initial review period, it appears advisable for the procedures staff to rely on the internal auditors for information as to the advisability of further reviews or revisions. Certainly the policing must be closely coordinated between the auditors and the system's personnel.

Physical Inventories

The Institute survey shows that better than 80 per cent of the companies do not take complete physical inventories, but test or observe instead.

I am sure that this was not the case a decade ago. I can remember this question being discussed in an Edison Electric Institute and American Gas Association meeting, about eight years ago. Internal auditors were taking complete inventories in a majority of instances. The present trend toward testing or observing, except in the class of material that is readily convertible into cash or personal use, is apparently rapid and good.

I will give you our Detroit Edison experience, which appears to be consistent with that in many other companies. I will be talking about general materials and supplies and not saleable merchandise.

Our Company program, until the beginning of World War II, included a complete inventory; once annually by the internal auditing staff and once by the Stores Department warehouse personnel. When manpower shortages developed during the war, the Stores Department gradually stopped their inventory work and did not resume until about 1949 at the request of the Auditing Department. We had two reasons for making the request that Stores Department personnel take their own inventories. The first and most important one being that it would enable them to discover their own mistakes and take corrective action more promptly. They have admitted since taking their own inventories that they had forgotten how to do the job, and did not realize the number of things that might be wrong without their knowledge. Secondly, we auditors preferred to spend less time on physical counts, and more time on other matters. We could not do this until we were satisfied that the operating personnel were on a sound program of their own. This took about a year after they had agreed to put the new program into effect. We are now taking inventories of approximately 20 per cent of the material items.

Accounts Receivables

We take just about the same attitude about auditing accounts receivables, as we do with respect to physical inventories. We do somewhat more *testing* of accounts receivable transactions than for materials and supplies. This, obviously, is due to the nature of the transactions.

Construction Costs

The trend toward more extensive audits of construction costs has been brought about by economic changes and the manner in which construction contractors operate. Conditions such as World War II and the inflationary trend have resulted in most of the larger construction contracts being made on a cost or cost-plus-a-fixed-fee basis, or something similar. Prior to World War II, we had mostly fixed-fee contracts which required very little auditing.

There is only one question asked in the 1950-51 Institute survey which indicates the internal auditor's responsibility for auditing construction costs. The question is whether internal auditors are responsible for auditing construction contracts. There were 151 companies answering in the affirmative and 73 in the negative. It is surprising to me that 73 companies reported their internal auditors as not auditing construction contracts. Some of this could possibly be due to the companies not having sizable cost-plus or similar contracts. I would like to believe *this*, rather than to know that many internal auditors do not concern themselves with this important activity under today's active construction program.

There is even a possibility that construction contracts on other than a fixed-fee basis may be with us for many years, if not indefinitely.

We have embarked on an extensive construction program in our Company whereby we have spent approximately 80 million dollars annually in recent years. A good share of this work has been done by outside contractors under special contracts usually involving some cost-plus feature. We consider it essential for the auditors to concern themselves with such matters as:

1. Examination of the contracts.
2. Determining the method of operation of each contractor and his policies and practices.
3. Internal controls and accounting procedures.
4. Costs versus estimates.
5. Field audits by internal auditors of pay rolls, materials and supplies, tools and equipment, etc.
6. Audits of sub-contractors.

There is a good description of the audit of construction contracts and costs in the Institute publication, "Internal Auditing in Action," published in 1951. The article was written by William Hahn, of the New Jersey Bell Telephone Company, Newark, New Jersey.

Just to indicate the value of auditing all phases of construction contracts, I will give one example of how we obtained a refund of $49,000 from one sub-contractor. In this instance, we observed that a sub-contractor was computing his fees on all payroll costs, including taxes and insurance; also that the payroll as charged included wages of operators of equipment such as trucks, boring machines, trenching machines, etc. Usually equipment of this kind is rented by the day or month, at specified rates, including the operator's wages. The contract between the prime contractor and the sub-contractor was quite vague as to its meaning in this respect. All persons concerned with the contract were consulted, with the result that it was agreed that the overhead and profit fees of the sub-contractor had been incorrectly computed. The fees should have been computed only on labor costs, exclusive of equipment operator's wages, payroll taxes and insurance. The sub-contractor immediately gave us credit for the $49,000. Incidentally, the public accounting firm for the sub-contractor established the amount of the refund and undoubtedly influenced his client to make the refund.

Public Relations

There are other phases of internal auditing than those concerning the direct work operations, that we should be interested in. These phases include the establishment of internal auditing courses in colleges, and other kinds of public relations. The Institute has recently done more in the area of establishing proper relations with the colleges, than in acquainting the general public about the profession of internal auditing.

The work of members of the Institute toward the establishment of courses in internal auditing in colleges, and toward furnishing material and instructors, has resulted in producing worthwhile results. I cannot quote the number of schools that have added courses, but I can assure you the list is substantial and growing. The Institute Educational Committee and our Managing Director have worked closely with the American Accounting Association. This has resulted in two publications being issued in 1952, and one that will be published in 1953 as follows:

1. The "Instructor's Manual for a College Course in Internal Auditing," originally issued by the Institute, was revised in 1952 and made available to colleges and others concerned.
2. A publication entitled "Case Problems in Internal Auditing and Control" was compiled by the Institute and published by Prentise-Hall, Inc., in 1952. The development of college courses indicated the need for problem material to be used in such courses. The problem material is a compilation of actual problems encountered in business.
3. The Institute is presently developing an Internal Auditing Educational Booklet which will be made available in universities, particularly in the business schools. This will be a booklet describing internal auditing and its place in the business world. It should be of assistance in encouraging students to enroll in courses in internal auditing.

Conclusion

I hope that I have given you enough material to indicate the trend of internal auditing philosophy and practices. There are many functions of internal auditing which I have not commented upon, but time does not permit me to do so. I hope that what I have presented may be of some assistance, and will present some thoughts for further discussion. I thank you for inviting me to present my views.

THE CONTROLLER'S EXPANDING DUTIES

By Edmund L. Grimes
Executive Vice President, Commercial Credit Co., Baltimore, Md.
National President, Controllers Institute of America

The word "expanding" has not only a *future* connotation, but a present one also. Facilities are expanded, generally speaking, with an eye to future business. We expand our sales departments to reach some larger goal. Our research efforts are expanded for a related reason—confidence that new products, new applications and improvements will be the end result. Expansion is dynamic: its face is always toward the new horizons. Hand in hand are also expanded responsibilities.

The same thing is true of the controller's duties today: the expression of business accounting—the use and interpretation of business facts to provide a basis for forward planning. A budget is a projection of past financial behavior into the uncertain future. The controller's reports are a part of management used as a springboard for future actions. Yesterday, in business, is significant only in terms of tomorrow. No wonder, then, that controllership is compared with navigation, which is the science of determining how far you have traveled and where you are, so you can chart a safe course for the future.

There are other grounds for equating controllership with growth and expansion. Small companies, for example, rarely have a controller. A firm must expand to a certain size and complexity before the functions which a controller ordinarily exercises come into being. Measured in dollars, it falls somewhere above $1 million net worth, or, for a service company, above $2 million sales. A company is a growing company before there is a need for a controller.

The Job Keeps Growing

The job of Controller itself in an ever-changing one. In 1931, when Controllers Institute was incorporated, there was no Securities and Exchange Commission; no National Labor Relations Board; no National Fair Labor Standards Act; no Social Security; no withholding or excess profits tax. World War II was undreamed of, with its train of legislation and government contracts. Who then thought of renegotiation, or of wage and price controls, or of a Controlled Materials Plan—all of which added new facets to the controller's job? Who could have imagined that unionization would reach a point where financial managements would have to take a seat at the bargaining table? Today, reopening a contract, or negotiating a new one, invariably confronts the controller with demands for facts and figures—some of them more involved, and many of them more far-reaching than those in the schedules for taxes.

Almost every other title used in business is clear cut and self-delineating: president, secretary, treasurer, general manager, sales manager, advertising manager, chief engineer, auditor, etc. But "controller" is not in this category, because the realm and functions of controllership are still unlimited. Every indication today is that they will go on expanding for many years to come.

Precisely because of this condition, everyone in accounting has a brighter and more significant future. Accounting is a tool, not a repository. Management repairs to it as to an oracle—the voice that foretells the future. The historical function of accounting, once all-important, now plays a less important role. The techniques of controllership, and the business leadership which controllership makes possible, have taken accounting out of the ticket office and given it a place on the team.

Challenges to Management

Let us review some of the challenges which make today's game worth playing for us all. Let us view these challenges with the broadest possible perspective—as management problems which we can help to solve, and secondarily as actual or potential assignments for controllers and accountants to perform.

What, today, does a business entity need most in order to succeed, in order to survive? Money? Manpower? Machines? While the "Three M's" are still essential, there is an antecedent need which outweighs all three together—*Planning*.

You can endow a business with millions. You can staff it with all the required technical skills and talents. You can equip it with all the newest and best machinery, but it will fail without a *plan*. "Planning" is the all-important word in the business lexicon today. Those who ignore it or merely pay it lip-service are whistling their way to the graveyard. And those who have a plan, but do not make it work, are bound in the same direction.

Budgetary Problems

A budget is a plan, but there are poor budgets, and some that are poorly worked. To be useful at all, a budget must be based on a forecast, and business generally is only beginning to learn how to predict its sales and its capital requirements for translating its fair share of the estimated market into actual production and deliveries.

We all know of companies where the only "forecast" is the sales manager's guess, which he in turn arrived at by adding up the salesmen's hopes for the coming year. Thousands of companies rely on such predictions, discounted by some, expanded by others. They measure the effort, rather than the market. And in doing so, they gamble on a host of forces which can make or break the business—the economic cycle, shifts in population, changes in consumer preference, the impact of inflation, the expansion or contraction of spendable income in the hands of consumers. Is it any wonder that business turns more and more to the letter "p."

There are companies, too—their name is legion—where capital budgets are conspicuous for their absence. As a member of our Institute, Mr. Edward W. Buge, pointed out a year ago in *The Controller* Magazine, it is entirely possible for a company to be prosperous, but well-nigh broke, as far as working capital is concerned. As he observed in his article, which received nation-wide publicity, quick corporate assets, cash and government bonds, are at their lowest ratio since 1939. This means that if business slows down for any reason, companies which have too little working capital, or which are engaged in a large expansion program, may have to curtail their programs, even their production, to make ends meet.

Budgeting *cash* is the best way to avoid such situations; it forces the management to think ahead and plan its expenditures with an eye toward an adequate cash position. To quote Mr. Buge, "The use of a good, currently revised cash forecast has resulted in fewer gray hairs for controllers and has improved the disposition of many a management committee. Short-term cash forecasts help to meet routine requirements, such as payrolls, discounting invoices, dividends, etc., while long-term forecasts are useful in connection with plant expansion, debt retirement and approximate cash needs for as long as a year ahead."

Avoiding Budget Errors

Our Institute has a Committee on Management Planning and Control which has compiled and published some excellent "do's" and "don'ts" for successful budgeting. The "don'ts" are especially helpful, because they put a finger on a number of practices which our membership has found impede the course of budgets. Here are some selected pointers:

1. Don't install a budget system if management is unwilling to accept or comply with full cooperation.
2. Don't fail to secure executive approval of buagets before issuing statements.

3. Don't let the budget be a creation of the budget officer alone. It is essentially an operation function of department heads.
4. Don't force budgets on department heads. Make the budget a joint venture. Work out the results together.
5. Don't classify all capital expenditures on the same basis. Consider them as "urgent," "current," or "desirable" projects.
6. Don't fail to have a definite plan for the administration of the budget after it is established.
7. Don't budget too far in advance. Short term budgets (usually for one year or less) permit more realistic comparisons with actual results. They also permit closer adjustment to changing conditions.

When Budgets Go Haywire

Perhaps the world would be an easier place for controllers and accountants if a budget, once made up and approved, would run along like clockwork. (There might also be fewer opportunities for controllers and accountants, if you will permit the aside!) The forces which impede and deflect the operation of a budget are many and varied, but there are two which are particularly potent. I refer to taxes and collective bargaining, both of which have a way of upsetting our neat figures. Fortunately, and here is where the dynamic nature of controllership comes into play, we can do something about them.

What can we do about taxes? First, we can help management minimize, shift and defer the burden of taxes through inventory pricing and accounting, through allocations of cost and purchase price, by selecting or changing the accounting period, and so forth. Second, we can help to spread tax consciousness throughout our company and client organizations, so that the tax consequence of every decision can be weighed *before* the decision is made. When this goal is reached, management's budget for taxes will not be constantly upset by unforeseen and unprepared-for imposts.

What can we do about wage increases? What I do wish to emphasize here is the fact that many companies enter into negotiations without preparing their negotiators to meet and answer unforeseen demands. For example, consider the problem of evaluating, or "pricing" a change from a 40-hour week to a 35-hour week. What effect will a guaranteed annual wage have on a company's "break-even point?" What "hidden costs" are now being absorbed, and how much will they be increased by currently popular "fringes"—such as an added week's vacation for over 15 years' employment? Misinformation and lack of information is harmful to both parties.

Some companies have such information well worked out in advance of the bargaining period, so that when a given demand is presented, both sides can quickly learn what its effect will be on company earnings and job security if it is adopted.

Conclusion

The meaning of such instances is plain, and there is no need for piling up the evidence. In its accounting departments, and in its C.P.A.'s, management has resources, both human and technical, to solve problems and overcome obstacles of the highest magnitude. It is up to us, as accountants and controllers, to perfect our accounting tools and to demonstrate our proficiency in their use. As we succeed in doing that, we will grow in stature and attainments, as well as in usefulness to society.

FOURTH SESSION

THURSDAY, MAY 21, 1953—7:00 P.M.
Ohio Union—West Ballroom

Presiding:

WALTER C. WEIDLER, *Dean, College of Commerce and Administration, The Ohio State University*

Paper: "Take the Mystery Out of Business"

CHARLES R. HOOK, *Chairman of The Board, Armco Steel Corporation, Middletown, Ohio*

Presentation of Accountants to The Accounting Hall of Fame

FOURTH SESSION

Dean Weidler: To all of you and your associations, our sincere thanks for your friendship and cooperation. I deem myself a very lucky person, indeed, to have the privilege of associating with you in this and in so many other connections.

I come now to the introduction of our principal speaker of the evening, Mr. Charles R. Hook, Chairman of the Board of Armco Steel Corporation. This is the second time I have had the privilege of introducing Mr. Hook. The first occasion was in June, 1939, when I had the privilege of presenting Mr. Hook for the honorary degree of Doctor of Laws, conferred by this University. Altogether, I believe nine universities have similarly honored Mr. Hook, recognizing his distinguished contributions to industrial institution and management and to good employer and employee relations. His industrial career has taken him from office boy in a small rolling mill, through an apprenticeship in the difficult art of roll turning, to the superintendency of what was the American Rolling Mill Company at Middletown, to the presidency of his company, and to the chairmanship of its Board of Directors.

His services to industry and government are too numerous to attempt to enumerate. He served as president of the National Association of Manufacturers. He served as chairman of its Board of Directors. He is presently honorary Vice President of the Association, and Director of the Association. He served as chairman of the Industrial Relations Committee of the International Management Conference.

In World War II he served as a member of the Labor-Industry Conference, the forerunner of the National War Labor Board. In October, 1947, he was named by the American Society for Metals as the recipient of its medal for the advancement of Metallurgical Research. In October, 1950, he received the Henry Lawrence Gantt Medal for Distinguished Achievement in Industrial Management as a Service to the Community.

For many years, he has actively participated in the Boy Scout movement. He has served as a member of the National Council of that organization. In 1949, he was given the Silver Buffalo, the highest award of the Boy Scouts.

He is presently chairman of the Board of Junior Achievement, chairman of the Business and Finance Committee of the National Council of Churches of Christ in America.

Word just came over the wire this afternoon that Mr. Hook was elected to the Board of Governors of the New York Stock Exchange. That is a long record of distinguished service. It is a great privilege for me again to present Mr. Hook, who will speak to us on "Take the Mystery Out of Business." Mr. Hook.

TAKE THE MYSTERY OUT OF BUSINESS

By Charles R. Hook
Armco Steel Corporation, Middletown, Ohio

I appreciate most sincerely the compliment of being invited to speak to this distinguished group of accountants. I feel honored by the invitation, because no group has made greater progress on the management team or greater contribution to the progress of business than accountants.

When I started my business career as an office boy in 1898, the accountant was called a bookkeeper. He wore black slip-on sleeve protectors, and he sat on a high stool entering figures in thick ledgers. When he dipped his pen in black ink, we were very happy. But when he reached for the red ink, we all shivered. He was a silent man whose advice was seldom asked. How different today!

I have seen the rise of the accountant from bookkeeper to the status of a highly technical professional man. I have seen a whole multitude of laws enacted governing taxes, depreciation, and all the other phases of business which the accountant must understand and administer, and which require that you have almost as much legal knowledge as the company attorney. Before management makes any major financial decision today, the accountant is called in, and his calculations in reality approve or disapprove the proposition.

Selecting a subject of common interest for tonight's talk was a problem which gave me considerable concern. I am not an accountant, so I certainly cannot tell you how to do your jobs better.

There is, however, a subject of extreme importance to all of us, in fact, to all who believe in representative government and free competitive enterprise. In the past two decades, we have seen our freedom threatened time and again—our freedom as businessmen and as citizens. So I chose the subject "Take The Mystery Out of Business." When we take out the mystery—and to the average man there is plenty of mystery in business —we have understanding. And when we have widespread understanding, we do not need to fear a Socialistic or a Communistic future.

To an accountant there is no mystery in business. You know every bone in the business anatomy. You know what makes business click. There is not anyone on the entire team better qualified than you to create understanding.

Some of you may say, "What is the use of wasting time talking about taking the mystery out of business when we have a Republican administration in Washington?"

I have crossed the English channel when it was almost as smooth as glass. And just a few days later when I came back, it was rough as could be.

It *can* happen again.

Right now business is not on the griddle, but it is on trial. Businessmen are being called to Washington to take responsible positions of leadership. I think this shows that the public has greater faith in industry and business than most of us ever realized. This is a time for businessmen to demonstrate that they are not only leaders of our country's productive forces, but statesmen as well. This is a time for re-grouping and re-vitalizing our forces. If we do not recognize our opportunity and make the most of it, business leadership will find itself on the outside looking in.

All of us, of course, cannot be invited to serve in Washington; but we can all contribute to the understanding of our fellow citizens in our plant, in our office and on our street. For this reason, I would like to direct my remarks to the accountant's opportunity to bring about understanding of the simple fundamental economics of business.

I am here to talk to you about a few things that you can do—perhaps better than anyone else—as a part of management to bring about a better understanding of these fundamental and simple facts that are controlling influence in the successful operation of business.

I have said many, many times that no great work was ever accomplished without much cooperation. There can be no real cooperation until there is confidence based upon the foundation of understanding.

Just thirty-one years ago last week I was asked to address the annual convention of the Ohio Bankers' Association. Let me read several paragraphs from that thirty-one year-old talk: "Win the Confidence of Employees by Taking the Mystery out of Business."

"Neither men nor nations can get together and cooperate in their common interests until there has been established confidence built upon a foundation of understanding.

Take the mystery out of business should be the slogan of present day management; plans should be adopted and every possible effort put forth so that the fundamental economics of business, and particularly of the wage question, can be simply and clearly explained to the organization."

I emphasize that again today.

"What do I mean by 'taking the mystery out of business?' Just this:

"The vast majority of people, whether they work solely with their hands or their heads, have neither by education, training nor experience been able to grasp the real meaning of the words 'capital,' 'surplus,' 'invested capital,' 'profits,' 'dividends,' 'gross earnings,' 'net earnings,' 'overhead,' 'depreciation' and innumerable other words descriptive of vital factors entering into present day business.

"To the average individual there is a mystery surrounding all these things that breeds suspicion and opens the door to the false prophet and the agitator.

"We are too timid in advocating the capitalistic system, especially in view of the fact that it is the only system which has stood the test of time, and which can properly reward individual initiative, ability and ambition.

"The first capitalist was he was first spent less than his income, or, before the time of money, consumed less than he produced.

"When a man spends less than he earns, we are accustomed to refer to his savings as the product of thrift. He is a capitalist to the extent that he accumulates savings.

"Five men join their savings and organize a little company. For their money they receive stock certificates; the certificates represent the capital stock of the company and are the accumulated thrift of five men.

"The little company may be successful, and through careful management, spend less than it receives, and thereby accumulate savings in the same manner as the individual or group of individuals. Remember that in determining the savings of a company such items of expense as depreciation must be considered, because depreciation is spending money in the form of 'wear and tear.' These company savings may be used to buy more brick, mortar, machinery, etc., and shown on the books of the company as surplus. This surplus, being in the form of bricks, mortar, etc., cannot be divided among the stockholders, so they *may* be given stock certificates to represent their share of this accumulated thrift of the company.

"Five thousand people can just as well join their savings as five people, in which event you may have a large corporation with a large capital, representing the accumulated thrift of many people.

"Stop nine out of ten men whom you might meet on the street and ask them what 'surplus' is, and they would probably answer 'cash in bank'. These same nine men, if they read in the paper that the U. S. Cracker and Crumb Co. had earned $100,000.00 last year, would conclude that this $100,000.00 represented cash paid to the stockholders.

"A determined effort must be made to explain clearly the relation that wages and production per man bear to costs, company success, and continuous employment."

Is there anything more important today?

"Men are square; the vast majority of the workers want to do right, and in my opinion, will quickly respond to a square deal. It is, therefore, the responsibility of our industrial leaders to devise plans whereby the rank and file can secure from those in whom they have confidence and who from knowledge and experience are qualified to talk, a clear and simple explanation of the problems of business as they relate to financing, production and marketing.

"Whip the soap-box orator with facts placed in the hands of 'the man on the job.'

"You may properly say to me, 'That's all fine talk, but how are you going to do it?'

"It would be foolish for me to prescribe a plan that would be suitable for all organizations. Mills, factories and offices have character and mannerisms just as do individuals. What might work in one plant might not be suitable at all for another organization. It is not the form but the principle that is important.

"Any plan that provides a proper contact between those who manage, and those who do not have management functions will be satisfactory as long as there is a genuine desire to cooperate on the basis of true Christian principles.

"If you have not been willing to take the time and make the necessary sacrifices to present to the organization the facts with reference to the problems of management and the fundamental economics of business, be a good sport and don't whine if these same men listen to a false prophet."

Remember, this was written after eighteen years of experience in discussing with groups in our organization the things that make a business tick, that govern costs, wages, sales, competitive position, and continuity of employment. I have not changed my opinion in the slightest degree since this was written.

Now let me use a couple of simple examples which we have used effectively to create understanding of some of the basic elements of business which may seem very elementary to you.

Take that much-misunderstood question of depreciation. Many industrial workers—even though they may know how to read and understand a financial statement—view with suspicion that item of depreciation. Here is the way I have explained it many times.

Let me tell you how I happened to determine to use this simple illustration. It was in June, 1945. I turned on the radio, and I was listening to one of the labor leaders whose name is in the paper almost daily. He was shouting to high heaven that business, industry particularly, was hiding its profits in reserve accounts; and he referred particularly to the item of depreciation and amortization.

I made up my mind that if our men did not understand depreciation, we were going to do something about it. So the next morning, while I was sitting at my desk, I telephoned to our director of public relations; and I said, "Hugh, I want you to buy a new pair of shoes such as the men in the mill wear, not on Sundays, but their every day shoes." He said, "Boss, what do you want that for?" I said, "You get the shoes, and I will tell you."

In the afternoon I got to thinking about it and called him again. I said, "If you can, go out on the dump and find a shoe exactly the same as the new one, same manufacturer, everything else; I want that too."

In several days he came in to me, and he brought a pair of shoes; here is one of them. Say they cost $5.00, to make it easier to calculate. Let us assume that the man can wear that pair of shoes for a year. What happens during the year? He breaks a shoestring and goes into his pocket and buys another shoestring and puts it in. He rips a seam, and he takes it to the shoemaker and gets it sewed up. The soles and heels wear out. He fixes them up. That is maintenance and repair. He takes that out of his pocket as he goes along.

But if he is a wise fellow, he will take ten cents out of that pocket, go to the kitchen, and put it in the coffee pot every week, because then at the end of the year, when this shoe becomes *this* shoe (*replacing the new shoe with the worn shoe*), there is no way you can do anything with it. You cannot repair it any more. It has to be replaced.

He goes to the kitchen and reaches in the coffee pot and picks out $5.00 and buys a new pair of shoes.

That is the same thing, we say to the fellows at the plant, that is going on in the plant, only with this difference. We have to go a good deal farther, because you accountants know that we are permitted an average of only 4 per cent depreciation. The government says to us, "This machine is going to last twenty-five years." How many of you men will stake your right arm that any one of the machines that are in your department will be there twenty-five years from now?

You know what happens. Sometimes in five years some machine we spent $300,000 or $400,000 for is outmoded because you come along with a better one. If we are going to be competitive and hold our costs down, we have to have one of your new machines, and out goes the obsolete one.

Where do we get the money? We have some in the depreciation account; but if we do not have earnings, profits, to back up our depreciation account, then we do not have the money to buy the new machine which is so essential to keep us in business and you in employment. It is continuity of employment that you are interested in, because you want a steady job and good wages. Therefore, you are interested in seeing that the company not only gets a fair allowance for depreciation, but also gets profits which will permit us to put something aside so that when we have to throw this machine away, long before its ordinary usefulness has ended, we have the money to do it and keep you in your job.

I am after our organization all the time to try to find simple illustrations to explain what seems to be a difficult problem.

Since the end of World War II, we have heard a lot about raising wages to increase purchasing power. And we are going to hear more of this catch-up or hold-the-line theory, as the case may be.

You and I know the fallacy of such an argument. You and I know that you do not increase purchasing power merely by increasing wages. What good does it do a man to earn $10 today and $20 tomorrow if his $20 will buy no more than his $10? In fact he may be worse off, for inflation will have eroded the value of his insurance policy and his savings, as many people have learned through bitter experience.

You accountants know this better than any other group. You know that in the long run the only sound way the purchasing power of wages can be increased is through increased production.

I think we should all be interested in increasing purchasing power of wages and elevating the standard of living. For this reason every member of management should be vigilant and do everything possible to counteract false philosophy which may undermine the upward trend of our national standard of living.

There, again, what do we mean by standard of living? We all understand it, but do we explain it? Do we take the time for some fellows who do not understand? All it means is our ability to buy more of the things we need and want with a day's work.

How do we do that? Well, there again, I am indebted to the radio for an illustration that came to me. This was in the fall of 1945, the same year that I heard this labor leader spout off. But here was a very fine man speaking on the General Electric Hour.

About three-fourths of the way through the program my very good friend, Charles E. Wilson, came on and made a five-minute talk. I listened with great interest. He was telling about the marvelous value in the electric light bulb that you buy today. It was selling for ten cents then. It is now eleven cents.

As he talked, I said to myself, "Gee, Charlie, if you could just tell them what was behind that ten-cent bulb—the savings over the years to make it possible to buy equipment, the necessity of profits, and so forth." The moment he finished I got up, went to the telephone and asked the girl to get me Mr. Charles Wilson in the NBC studios in New York. Mrs. Hook said to me, "What are you calling that man at this hour for?" I said, "You listen, and you will find out." It was not five minutes until Charlie came to the phone.

I said, "Charlie, that was a peach of a talk you made. I only wish you had time to tell the real story. I want you to do something for me. I want you to get somebody in your organization to give me the history of the development of the 60-Watt globe, and I will tell you why I want it. I want to use it as an illustration of how we develop and increase the purchasing power of wages, how we increase our standard of living." So he said, "All right. You will have it."

I waited for a month and did not hear from him. So I wrote him a letter and asked him what happened to that promise. He said, "We will do it for you; and, furthermore, we have a little present for you."

In about a week I got the present, and here it is. (*Shows a light bulb made in 1923*). First, I will tell you the history of the development very quickly. In 1893, Thomas Edison made up his mind that he was through with the experiments. He had shown that you could make the electric globe, and he was ready to do it on a commercial basis. So he licensed General Electric, and Westinghouse, and others, to make the electric bulb.

I will not tell you what the cost of the manufacture of a 60-Watt globe was between 1893 and 1906 because you would say I was crazy. But let us go to 1906, because it was in 1906 that the great development took place when they substituted the carbon filament with the tungsten filament. The 60-Watt globe sold for $1.75 in 1906.

I said to our industrial relations department, "I want you to get from the Department of Labor the common-labor rate for the country at that time and the average of the skilled and the unskilled." The average common labor rate was 15¢ an hour. The average of skilled and unskilled was close to 17½¢ an hour.

The average man had to work ten hours to buy one globe. How many globes could you sell? How many people could afford to have electric lights in their houses?

This is the present they sent to me. This globe was made in 1923 and sold for 40¢. This globe *(showing modern light bulbs)* I bought myself for 10¢. This modern globe gives 56 per cent more light with the same amount of current than the 1923 globe did. There is a 75 per cent reduction in price from 1923 to 1945, plus the savings, of course, in the light bill.

Now, that is the way we have developed the purchasing power of wages, by reducing the cost of things that wages buy: $1.75 in 1906; 40¢ in 1923; 10¢ in 1945.

Say to the men in the plant, "You never think about it. You go out in the kitchen and get a globe. How many minutes did you work today to buy a 60-Watt globe?" They can understand that. Then we say, and I am sure you will agree, that the only way we can increase the purchasing power of wages is by reducing the cost of things that wages buy.

How do we do that? When you trace cost to its source, it is practically all compensation for human effort. A furniture manufacturer immediately says to me, "Look. That statement is crazy. I know what my costs are. There is only 25 per cent labor in my factory."

Wait a minute. Here is a table. The labor cost started when the wood came out of the tree.

In other words, if you start a wage increase down here at the forest, and you do not produce more footage per man-day, then your costs go up and your price goes up. So the other fellow who buys from you wants more money, because he has to spend more of his time to buy your labor. It is simple all right, when you trace it. Go right back to the forest. The first thing they had to do was cut the tree down. Maybe they used an ax, and the handle of the ax is wood. You have to go clear back to the tree again, because the start of your labor cost was right there on that first operation. The blade of the ax is steel. You have to go right back to the ore from which the steel in the ax was made in order to compute the labor cost in that item of initial cost in the table. Now where does the accountant come into the picture? I believe you can join the line-up and get onto the playing field any time you wish.

Some companies publish news letters, plant magazines or other media of communications. From my own experience, and from public opinion polls, industrial workmen never feel they receive enough information about their company. It seems to me that you men who have such a vast store of economic knowledge can make a real contribution to the understanding of your organization. The editors of company publications will welcome your suggestions. I have talked with plant editors, and one of their chief complaints is they cannot get economic information for their publications.

Sometimes we assume that the retailers and professional men in our communities understand industry and business just like we do. This is often not the case; they are not antagonistic, they just do not understand. The service clubs and other business groups of the community want facts about business and our business system. Their contacts with individuals are often more numerous than those of the industrialist. Let us give them business facts.

Still another field is education. Leading educators with whom I have talked tell me that a great many teachers do not understand simple business economics. This is not said critically. The teacher, on the average, is a person who is highly devoted to his or her profession. But teachers work for government—not for private competitive enterprise, and therefore, do not have the opportunity to acquire the experience that leads to understanding. How can we expect our children to understand the economics of business if their teachers do not understand the subject? I think we businessmen are more to blame than the teachers. We ought to take a more active interest in our schools. We ought to open the doors of our businesses to the teachers. The least we can do is to become acquainted with those who instruct our children and give them the benefit of our viewpoint.

We can do the same with the ministers, another group whose community leadership is extremely influential, but whose world of experience is much different from ours.

The opportunities for creating understanding are endless. They have existed for years and years; but too often we have not recognized them, or decided to "let George do it."

In this endeavor to bring about an understanding of economic truth I see management as a team—battling to defeat the preachings of pseudo economists and the distributors of misinformation. I picture you as the pitcher on this team, hurling your ball of facts with care, deliberation and courage.

Imagination of a high degree is needed if we are to serve up economic information in simple and understandable form so employees and the public can understand, and our opponents will be unable to hit.

There should be a very close liaison between top management, the accountant, the director of industrial relations, and the director of public relations, if the most effective and understandable presentation of financial and economic information is to be made.

Oh! God, if men could see a little clearer,
Or judge less harshly when they cannot see.
Oh! God, if men could draw a little nearer
To one another. They'd be nearer then to Thee—
And understood.

PRESENTATION OF DISTINGUISHED ACCOUNTANTS TO THE ACCOUNTING HALL OF FAME

DEAN WEIDLER: In 1950, The Ohio State University established the Accounting Hall of Fame to honor distinguished accountants. This evening four accountants are to be so honored.

Professor William Paton of the University of Michigan, and Professor Jacob Taylor of the Ohio State University will conduct the exercises incident to the conferring of these awards.

PROFESSOR PATON: The Board of Nominations presents the Honorable Thomas Coleman Andrews for the Ohio State University Accounting Hall of Fame.

Thomas Coleman Andrews' formal education ended with his graduation from high school. He received a certificate as Certified Public Accountant in the State of Virginia in 1921. He served in World War I as Sergeant-Major of the Richmond College unit of the Army's S.A.T.C. In addition to many years of practice as a Certified Public Accountant, he served as Auditor of Public Accounts of Virginia, as well as Comptroller and Director of Finance of his home city of Richmond, Virginia. During World War II he served with the Fiscal Director in the Office of the Under-Secretary of War; in the Contract Renegotiation Division of the Navy Department; as Chief Accountant and Transportation Director of the North African Economic Board; and as an officer on the general staff of the Fourth Marine Aircraft Wing in the Pacific.

For his work on organizing and serving as the first director of the Corporation Audits Division of the General Accounting Office, he was given the 1947 annual award of the American Institute of Accountants for outstanding service to the public. He had a major role in preparing the section on Governmental Accounting for the Hoover Commission.

He has been active in the affairs of the American Institute of Accountants, serving as vice president, a member of its Council, Executive Committee, and other committees, including those on Cooperation with the Bar, Governmental Accounting, Budget and Finance, Cooperation with the Securities and Exchange Commission, and National Defense. Finally, he was elected president of the Institute for the year 1950-1951.

Mr. Andrews organized a firm of Certified Public Accountants in Richmond, Virginia, and was also a member of the firm of Bowles, Andrews and Town, actuaries and pension fund consultants.

President Eisenhower has recently appointed Mr. Andrews Commissioner of Internal Revenue. He is the first Certified Public Accountant to hold this office. His selection met with the universal and enthusiastic approval of his colleagues. The appointment is not only a significant recognition of the professional and personal qualifications of Mr. Andrews, but also a high tribute to the profession of Accounting during this critical period of our nation's history. It is fortunate that one of his character and training is available to meet this challenge of service.

For his distinctive service to his country and to the advancement of Accounting as a profession and his high devotion to public service, the Board of Nominations is proud to present Thomas Coleman Andrews for the Accounting Hall of Fame.

MR. TAYLOR: Mr. Andrews, for your outstanding contribution to the development of the Accounting profession, upon the recommendation of the Nominations Board, and under the authority and in the name of the University, I have the honor to inform you that you have been elected to, and your name has been placed on the Ohio State University Accounting Hall of Fame. In testimony thereof, I present you with this certificate properly signed, and with seal of the University duly affixed.

MR. ANDREWS: Thank you, Professor Paton and Professor Taylor. I am sure that everyone here understands that having been raised in a small and quiet community, and having received the honor that I have from my profession, I feel very grateful and very proud of this citation.

This Federal administration that I have the great honor and privilege of being a part of is one that recognizes that private enterprise made this country pretty largely what it is. It openly and unashamedly acknowledges that, and is willing to put its shoulder to the wheel to see that private enterprise receives the encouragement that it should have in order that the remarkable progress of this country may continue.

I do not think anybody in Washington is deliberately going to give business, if you wish to call it that, a handout. I do not think we are going to do business any special favors; but I think I may say that after twenty years it is probably not too early to begin to give it its due at least. I conceive it to be my duty as Commissioner of Internal Revenue, to contribute as much as I can to that laudable attitude.

I do not believe that it is one of the duties of the Commissioner of Internal Revenue to undertake, by the manner of his administration of the country's tax laws, to liquidate private enterprise and establish state socialism in the United States of America.

I should like to say one other thing in expressing my appreciation: I cannot regard this honor that is being given to me tonight as a personal tribute to me. I have a very simple reason for that. That reason is that my life has been one of constant help from others. I could never have been president of the American Institute of Accountants if there had not been people of great stature who were willing to promote the reasonable ambitions of others. Everything that has ever happened to me has been, not necessarily a stroke of good fortune, but, in any event, the extension of the helping hands of others. And I want to acknowledge that at this time.

I particularly wish to mention what Jay Phillips said at a dinner given in my honor in Washington recently. He paid acknowledgment to my partners who have allowed me to make these several excursions into public life, and without whose cooperation I could not have done it. So in my case, as usually in others, we can trace back to others the good things that come to us.

I, therefore, accept this honor that has been conferred tonight in that spirit, in full recognition of the fact that I cannot claim all the credit for myself, but must share it with those to whom I owe a great debt of gratitude. I thank you very much.

PROFESSOR PATON: The Accounting Hall of Fame was organized for the purpose of honoring both notable living accountants and also those who are deceased. Mr. Richard S. Claire a partner in the firm of Arthur Andersen & Co., will accept the next award.

The Board of Nominations presents Arthur Edward Andersen for the Ohio State University Accounting Hall of Fame.

Mr. Andersen, a native of Illinois, received the degree of Bachelor of Business Administration from Northwestern University. He was granted a certificate as a Certified Public Accountant by the State of Illinois in 1908. In 1909, the year after the School of Commerce of Northwestern University was organized, he was offered and accepted an instructorship in the Accounting Department. In 1912 at the age of 27, Mr. Andersen was appointed Assistant Professor of Accounting, thus beginning a twelve-year career with that institution which led eventually to full professorship and the position as head of the Accounting Department. He also served as a member and later as President of the Board of Trustees of Northwestern University. He was an inspiring teacher, and challenged students in his classes to think objectively. He had an unwavering faith in education as the basis upon which the new profession of accounting should be developed.

In 1913, he founded the accounting firm shortly after to be known as Arthur Andersen & Co., in which he was senior partner until his death in 1947. In his professional practice he continually stressed his profound belief that the Certified Public Accountant not only has a duty to serve his client on a high professional level, but a serious social responsibility.

Mr. Andersen served as President of the Illinois Society of Certified Public Accountants during the year 1918-1919; he served on important committees of the American Institute of Accountants, including those on the Form and Administration of Income Tax Laws, and the Committee on the Definition of Earned Surplus; was Chairman of the Illinois Board of Certified Public Accounting Examiners; and was a member of important committees of the United States Chamber of Commerce. He was one of the charter members of the American Association of University Instructors in Accounting, which later became the American Accounting Association.

In recognition of his attainments and contributions toward the development of Accounting as a profession, he received honorary degrees from Luther, Grinnell and St. Olaf colleges, and also from his alma mater, Northwestern University.

For his contributions as an educator and as an outstanding practitioner, the Board of Nominations is proud to present Arthur Edward Andersen for the Accounting Hall of Fame.

VICE PRESIDENT TAYLOR: Mr. Claire, for his outstanding contributions to the profession of Accounting, upon the recommendation of the Nominating Board, and under the authority and the name of the University, I have the honor to inform you that Arthur Edward Andersen has been elected to, and his name has been placed on the Ohio State University Accounting Hall of Fame. In testimony thereof, there is an appropriate certificate duly signed, with the official seal of the University affixed; and it is presented to you for and on behalf of Mr. Andersen.

MR. RICHARD S. CLAIRE: I knew Mr. Andersen fairly well, and I think I can say that were he living this would be one of the proudest occasions of his life.

Mr. Andersen, I think, was about 50 per cent accountant and 50 per cent teacher. He had a very strong interest in young people, in education, and in universities. On many occasions he referred to his teaching at Northwestern and to other occasions on which he had been offered positions at other universities. I think he was as proud of his academic accomplishments as he was of the development of his firm.

We in Arthur Andersen and Company are extremely proud that

Mr. Andersen has been elected to the Accounting Hall of Fame. We know that he would look upon this as a cherished citation, and we are going to look upon it in that manner.

I would like to express the thanks of all the partners in our firm for this recognition that has been given to our founder.

PROFESSOR PATON: Mr. Walter R. Williams, Vice President of the Union Dime Savings Bank of New York, will receive the next citation on behalf of Mr. Sprague.

The Board of Nominations presents Charles Ezra Sprague for the Ohio State University Accounting Hall of Fame.

Charles Ezra Sprague served his profession and his country as a teacher, soldier, accountant, banker, and author. He was graduated from Union College in 1860 at the age of 18 years. He served in the Union army for two years, being wounded at the battle of Gettysburg. Later he received two graduate degrees from Union College—Master of Arts in 1884 and Doctor of Philosophy in 1893. He was awarded an honorary degree from Olivet College in 1910.

Colonel Sprague was instrumental in drafting the first C.P.A. law in New York State in 1896 and was a member of the first Board of Examiners. He was a member of the Board of Directors of the New York State Society of Certified Public Accountants for several terms and a fellow at the American Association of Public Accountants.

At various times he taught at military academies and was one of the founders of the School of Commerce, Accounts, and Finance of New York University, where he taught for a number of years.

He served the Union Dime Savings Bank in New York City in various capacities for a period of forty-one years, and was president for twenty years until his death in 1912. He was president of the Savings Bank Section of the American Bankers Association in 1904-1905.

As an author he wrote two accounting classics, *The Accountancy of Investment*, which is a standard text in this field today, and also *The Philosophy of Accounts* in 1908, which was the first complete accounting text based upon the balance sheet approach to accounting theory which is in general use in colleges and universities today.

As a teacher he was held in the highest esteem and affection by his students and colleagues.

In recognition of his contribution to accounting literature and of his eminent services to the accounting profession in its early years, the Board of Nominations is proud to present Charles Ezra Sprague for the Accounting Hall of Fame.

VICE PRESIDENT TAYLOR: Mr. Williams, for his outstanding contributions to the profession of accounting, and upon the recommendation of the Board of Nominations, and in the name and under the authority of the University, I have the honor to inform you that Mr. Charles Ezra Sprague has been elected to and his name has been placed on the Ohio State University Accounting Hall of Fame. It is my pleasure to present to you this certificate duly signed and with the seal of the University affixed.

MR. WALTER R. WILLIAMS: I feel extremely inadequate as I receive on behalf of Union Dime Savings Bank and Colonel Sprague's family this certificate indicating that Colonel Sprague has been duly elected to the Accounting Hall of Fame.

Unfortunately, I was approximately six months old when Colonel Sprague died in 1912. The great affection and respect that my associates and I have for him come to us through his many friends and from the written records in our bank.

The citation that has been read to you is ample evidence that this man was not only an outstanding accountant and a banker, but in addition a gentleman of the old school, a scholar and a soldier. If time allowed, it would be most appropriate for me to describe to you the monument that this great man left in the City of New York in which 140,000 people have banded together, with their large and small savings deposits, to form one of the state's great institutions, with $335 million of resources.

As the first active President of Union Dime Savings Bank, this great accountant through his complete understanding of the needs and desires of the every day citizen, built the institution on a firm foundation. His high ideals and sound objectives still guide our operations and as our founders so prescribed, we are vitally interested in every citizen of the city, including those who can afford to save as little as 10¢ each week.

On behalf of the bank I wish to thank the Ohio State University and the Nominating Committee for giving this serious consideration to Colonel Charles Sprague; it will be with a great deal of pride that our Board of Trustees will receive this certificate and place it in a conspicuous place in our banking room. Thank you all very much for the opportunity to participate in this impressive ceremony.

PROFESSOR PATON: Mr. Gordon Gardner a partner in the firm of Price, Waterhouse & Co., will receive the citation on behalf of the next and final nominee.

The Board of Nominations presents Joseph Edmund Sterrett for the Ohio State University Accounting Hall of Fame.

Mr. Sterrett was among the founders and charter members of the

Pennsylvania Association of Public Accountants in 1897 and also of the Pennsylvania Institute of Certified Public Accountants in 1900. He served as secretary of both of these organizations from 1897-1900 and as president of the Pennsylvania Institute from 1904-1906. He was chairman of the first International Congress of Accountants which was held in St. Louis in 1904. He was president of the American Association of Public Accountants for two terms, from 1908-1910. He served as chairman of a committee to develop a plan for the organization of the American Institute of Accountants in 1916. He served as treasurer of the Institute from 1919-1922 and for many years served on its Executive Committee and the Council. He served as chairman of the Committee on Publications, a member of the Committee on Professional Advancement, on the Administration of Endowment, Public Affairs, and Accounting Procedure.

In the field of public service, he was appointed by President Taft in 1911 to the committee advisory to the Commission on Economy and Efficiency. He held a number of positions with the United States Government, especially those in connection with tax legislation. From 1924-1927 he was the American member of the Transfer Committee under the Dawes Plan, with the rank next to that of the Agent-General for reparation payments. In recognition of his distinguished services, he was decorated by the governments of Belgium, France, Germany, and Italy.

In the field of public practice he became, in 1891, a member of the staff of John W. Francis in Philadelphia, becoming a partner in 1893. In 1907 this firm was merged with Price, Waterhouse & Co. of which firm Mr. Sterrett was a partner until his death in 1934.

The early founders of our profession recognized that only through professional organizations could high standards of practice and ethics be developed. Among these founders, Joseph Edmund Sterrett was one of the active and farsighted leaders.

In recognition of his services to the profession during these formative years, and in recognition of his forty-three years of distinguished practice as a public accountant, the Board of Nominations is proud to present Joseph Edmund Sterrett for the Accounting Hall of Fame.

VICE PRESIDENT TAYLOR: Mr. Gardner, for his many conspicuous contributions to the profession of accounting, on the recommendation of the Board of Nominations, and in the name and under the authority of this University, I have the honor to inform you that Joseph Sterrett's name has been added to the Ohio State University Accounting Hall of Fame; and I have the honor further to present you with the appropriate certificate properly signed, with the seal of the University duly affixed.

MR. GORDON F. GARDNER: It is a privilege to accept the Accounting Hall of Fame award to Joseph Edmund Sterrett.

As outlined in the citation, he devoted much of his time to advancing the profession and serving the public welfare. A matter especially dear to him was the education and training of men for accountancy. Motivated by this deep interest, he was unsparing of himself in working on projects which would help young people to prepare for the challenge and the opportunity offered by the profession. The example which Mr. Sterrett set, and the high standards which he advocated, inspired many others to like endeavor. The fruits of these collective efforts can be found in the expansion of accounting services, and the important place in the nation's economy which our profession now enjoys.

Every member of my firm joins me in expressing appreciation to the Board of Nominations and to the Ohio State University for honoring Mr. Sterrett, whose life accomplishments we remember with pride and admiration.

FIFTH SESSION

FRIDAY, MAY 22, 1953—10:00 A.M.
Ohio Union—West Ballroom

Presiding:

RUSSELL H. HASSLER, *President. American Accounting Association; Professor of Accounting, The Harvard Graduate School of Business Administration, Boston, Massachusetts*

Paper: "Looking Over Your Shoulder at Education"

F. KENNETH BRASTED, *Director, Education Department, National Association of Manufacturers, New York, New York*

Paper: "Research in Accounting"

THOMAS LELAND, *Professor of Accounting, Texas A. & M. College, College Station, Texas; former Director of Research, The American Institute of Accountants; Past President, American Accounting Association*

LOOKING OVER YOUR SHOULDER AT EDUCATION

by F. Kenneth Brasted
Director, Education Department
National Association of Manufacturers
New York, New York

It is indeed a pleasure to visit once again your Annual Institute of Accounting. When I was invited to address you this year, Dr. Miller mentioned several of the topics which other speakers would be discussing. Naturally, most of these were primarily concerned with specific phases of your own profession. I felt, therefore, that it might be appropriate for me to talk about some of the broader educational problems concerned with the training of young people today, in accounting as well as in other areas. Besides giving you a change of pace, I want to capitalize on the current interest in education, and especially those areas of education with which business is vitally concerned.

Mr. Hook last night certainly set the stage for this talk this morning when, among other things, he placed great emphasis on the need for creating understanding of our business system among teachers and their students.

It has been said repeatedly by numerous spokesmen for both the business of education and for business itself, that right now education is the biggest business in America. At a recent conference of educators and industrialists in Philadelphia, NAM's President Sligh said this: "Education is the biggest business in America today. It has the largest number of owners, the most extensive and costly plant, and utilizes the most valuable raw material. It has the greatest number of operators. It employs our greatest investment in money and time, with the possible exception of national defense. Its product has the greatest influence on both America and the world. Everyone engaged in this business, from the custodian to the college president, should be proud, and should devote all possible effort toward improving and perfecting his part in it."

Several of your own professional associates have been most active in helping higher education to train men for a future in accounting and business management. Business and industry indeed have been lending steady hands in guiding our schools and colleges whose graduates are headed for business and industry futures.

The National Association of Cost Accountants through its local chapters, sponsors forums and workshops stressing efficient management. In these, both students, faculty, and business leaders have actively participated.

The American Institute of Accounting has played an important part in developing an extensive training program which would steer future accounting personnel into proper placement in industry and business. The Society of Industrial and Cost Accountants of Canada has also cooperated with all leading Canadian Universities in establishing standard requirements for accountants, and the universities have geared their curriculum to meet those requirements, and to satisfy the demands of industry as they change. I notice that they stress as final requirements, the stability and perseverance of the individual, as well as his ability to organize and direct the work of others.

The Controllers Institute of America is also extensively engaged in an educational program. It is doing some fine advisory work in the field of helping both business students and corporation employees who are working on every phase of management, accounting, and control, to know their possibilities for the future. They stress the advisability of working with firms which have a public responsibility, and they emphasize the ethical values which show up in that type of company, for the benefit of not only the employee but of the public at large. Here certainly is evidence of areas of mutual growth and cooperation between industry and education.

It is interesting to note that in their program on the collegiate level, where they initiate discussions in the accounting field in which both faculty members and students take part, they have discovered certain objectives which they believe should be part of a college education. These objectives particularly emphasize the development of the communicative arts, and a basic knowledge of human relations. In other words, they feel that the student, particularly the student who is headed for industrial accounting, should have a strong general educational background rather than just training in specialized subjects. They recognize that it is probable that the latter would be subject to change if he entered a corporation which had its own particular system of accounting. This seems to be a general trend of thinking among the leaders in various fields. The swing from specialization has shown that the all-around man is in as great demand, perhaps greater demand, because of his potentialities as a future leader.

Now, so much for my "carrying coals to New Castle." I have mentioned these activities which you and your counterparts across the country have presumably analyzed, approved, and supported. These are the educational problems which you as a profession have fairly faced.

But it seems to me that there are many other problems of education which you have been content to glance at—simply "Looking Over Your Shoulder at Education." Let us talk about these in some detail. In so doing, I want to divide my discussion into four major areas.

First of all, I believe that the mass production era in which we exist has made tremendous demands upon a system of education that had its roots in a bygone period of emphasis upon traditional styles of learning. In brief, there has been a tremendous pressure put on what we inherited from our founding fathers in the way of the public education system, a pressure for more of, and a better product from, education in general.

The second area in which problems have arisen might be expressed in the word "time." I mean by that the amount of time which it still requires to finish the work thoroughly for a college degree—4 years for the bachelor's degree, 5 or 6 for the M.A., and 7 or 8 for the Ph.D. Here there is a definite conflict between the time necessary, and the speed-up in all our ways of living.

The third problem that arises in all education is the increased amount of materials and equipment needed to facilitate education. In higher education, the costs of laboratory and research work with the accompanying equipment and buildings have greatly swollen the cost of operation for every college. The tuition returns cover as little as 25 per cent, in some cases, of the cost of carrying each student.

And lastly, the fourth problem of actually housing the tremendous number of students today, particularly in elementary education, casts a large shadow across our coming generations.

I would like to make a little more detailed inventory of the above four areas in order to show the situations in which education is working in order to turn out our citizens and workers of the future—the citizens and workers who we hope are the best equipped in the world for every phase of our social and economic life.

I might preface these remarks by saying that our very own industrial progress has been in a large measure responsible for the situation as it now stands. Business and industry are now looking to education for their future workers and creators. It is only fair that they also look over some of the conditions which could be remedied in the future, conditions which have followed the great progress of our industrial civilization of the last 100 years in this country.

I mentioned the *pattern* of mass production which education has been forced to follow over the last 75 years. Existing in a mass production era, it has had to supply manpower as rapidly as demanded by business. The demands of several wars put further pressure on the whole educational pattern; the supply of scientists, engineers, doctors, lawyers, and accountants which has been required, forced our colleges into speeding up their programs at various times. It is not easy for institutions which undergo such changes to get back to normal, to their previous pace of being an intellectual or cultural center. They are apt to retain the characteristics of a machine that must grind out finished products with various and sundry backgrounds tagged with college degrees.

The second point I mentioned was the *time* that it takes to attain a level of learning for each individual during his best learning years. Four years of a man's life are not really very much, and yet that period marks a transition point into adulthood, where his thinking capacity is made or broken in terms of what a man believes will be his calling. Also, nowadays, the undergraduate must consider all kinds of problems dealing with the social, economic, and international scenes, which are in competition with his devotion to purely intellectual pursuits. In short, thinking is a lonely business, despite the values which our new developments in the line of social and group thinking have been claiming. The elementary and secondary public schools have also emphasized diversity of training, in order to prepare oncoming generations with an ability to meet mature situations and to solve other problems which rapidly occur in this day.

The third point I made was about the increased material requirements which are needed in education today, that is, the equipment which is used in such areas as the sciences—with their research work and enormous laboratories; the arts—with the many possibilities of visual and audio-visual techniques; and the humanities, which basically depend upon books anl libraries. In connection with libraries alone, we must not forget as an example, that they also need their browsing rooms and places for individual research. It was not until the 20th century, and for some colleges only a decade or two ago, that adequate collegiate libraries came into being. As recently as 50 years ago, some colleges had fewer volumes on their shelves than did the local literary society.

I have no doubt that most of you are familiar with the falling off of returns from endowments to private institutions, and the increased costs per student in keeping colleges operating at the level which tradition and modern developments demand.

My fourth point about the lack of space is easily explainable with a few facts. There are now more than 27 million elementary and secondary school youngsters in this country—crowded into space meant for 18 million; that is, 3 children for every 2 spaces. Eight hundred thousand of these are in classes of fifty or more. One educator estimated that a one-story building, 52 feet wide and stretching from New York to San Francisco, would answer the needs of housing school children in the foreseeable future. This would include an estimated increase of one million per year until 1958. Just where and how such numbers are to be handled on a scale which is commensurate with our present day standards of what constitutes a good educational system, is beyond the thinking of our best planners. $10.7 billion is needed right now for more classrooms. You may think you should be more concerned with the fact that by 1975 these growing children will need 24½ million more jobs than in 1950—$12,000 a job equaling $294 billion. But what could be more important than those who will fill those jobs?

The crux of this situation is viewed by many in both the educational and business world as having arisen from the gap caused by our tremendous advancement in science as it was applied to industry, and the progress in one aspect of our socio-economic environment, in the training of our young. Perhaps it could be simply stated by citing the old story of the hare and the tortoise, only this time the tortoise did not catch up.

In almost every instance where educators, parents, and outside experts of the business world come together on such problems, it is the question of how to catch up with our material progress that seems to puzzle everyone. Sometimes it is called our moral and spiritual development or the lag in our culture, but it all has the same implication for our future course. When and how are we going to remedy this need?

I have taken up the preceding four conditions affecting present day education because I believe it will give you a clearer view of what to look for from educational institutions, so that you will not be disappointed in the product of both schools and colleges. I do not mean to state this in an apologetic way. Education today is a modern business, "as modern as your business," to use the words of the former commissioner of education, Dr. John H. Studebaker. He also admonishes us that we should not be overcritical of people who are trying to make improvements in the educational system. Furthermore, we must not be foolish enough to assume, when awarding high school diplomas, that all graduates have the same knowledge, talents and capabilities; that they are all alike. They are not, and they never will be. God did not make people that way.

Industry knows full well the contributions that it has received from the research side of education alone. The products of higher education—from the laboratories' first revealing of new ideas, to the classrooms' making those theories understandable, are indeed responsible for industry's moving forward over the years. Out of some of this so-called "useless research", has come the kind of fundamental knowledge that has made possible sources of military power like the atom and radar, and has formed the basis of new peacetime industries, such as the antibiotics, electronics, plastics, and countless others.

The progress for which colleges and universities have been responsible in this country might be called the greatest tribute to a free economy and to private enterprise since the middle ages. As President Dodds of Princeton said about the status of private institutions of learning, they are "islands of independence in education, without political accountability."[1]

I need not go very far in citing the present status of education in countries where the devotion to the principle of free and independent institutions has been sacrificed to the immediate goals of a party or person in power at the time. In his book, *Education and Liberty*, Conant of Harvard presents America's problem of preserving our cultural independence while still forging the national unity necessary for survival, and says the solution depends upon our ability to maintain the existence of diversity and flexibility in our public schools.

Dr. Studebaker has said, "As educators, our aim is to help each child attain a reasonable mastery of learning tools. These tools will enable him to continue the learning process throughout his lifetime." For some critics, that explanation is not sufficient. I have mentioned the fact that there have been disappointments, in the results of our educational system in some current crops of high school and college graduates.

One teacher of commercial subjects in one of the New York City High Schools made a one-man survey to ascertain some of the answers, by visiting 13 companies and talking with their personnel managers. His report was not very encouraging. The demand for young office workers seemed to exceed the supply sufficiently to give most high school graduates jobs, but the businessmen felt that they were not prepared for those jobs. First of all there seemed to be an inability to do simple arithmetic, mentally or on paper; an inability to spell the most common words or to know their meanings; and several personnel men cited the fact that many could not read, comprehend or route a letter properly.

A great deal of criticism has been leveled at the schools for their failure to teach the so-called 3 R's. Sometimes this has been justified, but at other times it has not been thoroughly thought out.

Some of those who insist on schools dealing only with the past and with abstractions, have not realized that it is an important responsibility

[1] Refer to: The A. P. Smith Manufacturing Co. case before The Superior Court of N. J.

for schools to keep their products not only alerted to the threats on freedom, but also to train them to be able to solve everyday problems in effective living. The other side of our story about the commercial teacher who made his survey showed that some employers had little discernment in differentiating one high school diploma from another, or in caring whether the term "high school graduate" was all inclusive, or related to specific courses of study. Such was especially true where employers had few or no students for achievement measuring, and where their complaints and criticisms were in generalities and not constructive. In other words, our inquiring teacher wondered whether we in business were fair to our charges.

In speaking further of what industry and business look for in the higher level of education, I believe that the general picture is one that represents satisfaction on the part of most companies. Here the problem is one of finding enough men and women to fill the needs of business and industry. In fact, industry is recruiting college men in somewhat the same manner that baseball scouts operate for their clubs or chains of clubs. A recent survey of 195 companies by the National Industrial Conference Board reported that the scramble this year would be even more hectic than last. There will be fewer students graduated, and the shortage of them, especially in engineering fields, will be even more acute. Also only 25 per cent of the male seniors this June will have completed their military duty tours. One ray of hope shows up in the fact that many young men recruited 2 or 3 years ago may soon be returned to civilian life. While most companies last year did not fill their quotas of required men, this report stated that they were optimistically planning to exert more effort this year in campus recruiting.

Insofar as the professional preparation of college graduates is concerned, there seems to be little doubt that the men coming through have the necessary equipment and knowledge. The conditions that I mentioned before did not seem to be as prevalent as they were among high school graduates. The basic preparation of college trained men is adequate for the jobs into which they are placed.

I want to speak of something else which is often taken for granted, the intangible something which seems to bring certain men to the top in roles of leadership. Management has been concerned with this intangible for years, as it is at the base of their many problems among all persons with whom they have relations. It might have been St. Paul who said, "Now abideth products, prophets, and persons . . . and the greatest of these is persons."

We in business and we in education have too often taken for granted the development of the human values which play so important a part in effective learning and living. We should understand that business expects from the colleges and universities a basic belief in, and an appreciation of, certain fundamental moral and ethical values which are required for sound relations between man and his fellow man. According to our leaders of modern society today, it is this lack of man's understanding of his fellow man that has caused the conflict or race, whichever you may call it, between science and the methods which society has used to carry out new scientific principles. Even with our advanced techniques in modern education, the gap seems to widen with every new discovery made.

If we could still retain the free exchange of ideas symbolized by Mark Hopkins on one end of the log, and his 19th century student on the other, perhaps present day problems would come into clearer focus. Certainly the educational speed-up and short-cut methods have not provided any better answers than the older ways which still exist within the ivied walls of many of our colleges and universities. When the first conference was held at Arden House in 1949 by the American Assembly, (an idea of Columbia's President Eisenhower), one of the participants claimed that their final and most enlightening conclusions were reached by means of the simple educational principles I have described above—a face to face exchange of ideas. Thus, education comes up against the dilemma of how to continue operation on a mass production scale, and yet retain the simplicity of so simple a theory of education as that of the value of personal contact.

You and I of both the business and the educational world realize that the answers to some of these questions are not just around the corner.

Before getting the answers, we have to decide in some measure just how we are going to improve our schools, or whether we are going to change the whole pattern of education. We as Americans must make that decision, and the nature of such a decision needs all of the understanding we have. Some combined efforts have already been made by industry and business, namely such moves as the Ford Foundation's contributions toward the advancement of education; Harvard Business School's investing a half-million in scholarships for future business leaders; and Corning Glass Works' organizing a conference of industrialists, unions, representatives, and scholars in cooperation with the American Council of Learned Societies, to discuss the underlying issues of the gap between technological growth and human values, as understood by students of the humanities. These are but a few of the many fine education-industry cooperative activities being carried out now, with the number increasing daily.

Neither education's leaders nor businessmen can be certain that they have the final answer as to how to solve these problems which are basic to the nature of humanity, both as individuals and as groups. We note that some research has been done in this area; about 10 per cent of all research falls into the categories of the social sciences or humanity, as shown by a recent *New York Times* report on college and university research. Additional investigations are needed in a wide variety of school and community situations, if we take seriously the position that human relations problems are of essential importance to our contemporary culture. According to Clarence Randall, of Inland Steel, the human resources of industry have been neglected for too long a time. We have been stock piling all kinds of materials and knowledge about everything for the last 50 years, with the exception of our human resources.

In the philosophy of Bertrand Russell, this divergence in the aims of our socio-economic culture and the means of reaching those aims were expressed as follows: "Man has hitherto survived because he was too ignorant to know how to realize his wishes. Now that he can realize them, he must either change them or perish."

The National Association of Manufacturers has had a policy of educational support for a number of years which is best exemplified by its October 1951 resolution. In the main, the objectives of NAM rest upon a recognition of the principle of a free and equal opportunity for all of young America at every level. This is implemented by our promotion of activities in which members of industry, both as individuals and as company representatives, can take part in exchanging ideas and rendering support to the educational world.

Not only is that support forthcoming in the form of industry-sponsored activities which have opened the door to cooperation with educators on mutual problems in local areas, region and state wide areas, but it has also led to the individual's participation on school boards and boards of trustees.

In mentioning this mutual cooperation—an expectation of something from one another that is for the good of both—Frank Abrams of Standard Oil Company (New Jersey) has this to say, "I would like to make the point that management needs from colleges and universities young men and women who can see and understand business as an integrated and essential part of the whole social structure—men and women with all the good qualities of character and intelligence which the nation as a whole requires. We want them to be independent in their thinking; able to see things in their full dimensions; interested in the welfare of their fellow men and confident that the world can be improved; aware that it is a tough job worth the best in them, and ready to work for what they believe in."

It is this type of leadership that business and industry look for from education. They are also looking for leadership which will exert itself in fields of community interest which are closely related to their organization's welfare. That, of course, includes the education field itself from which industry's new blood has just emerged. With the problems of education so imminent today on every side, industrial leadership that comes from the colleges must be able to view the future of our schools and colleges in such a way that they will be aware of the necessary changes.

For instance, as our population grows up, and as the length of life is steadily pushed farther and farther into the future, our population is becoming more and more a middle-aged population. This alone is a challenge for the leaders who are being trained by education today, and who will be the leaders of industry tomorrow. Here I am referring to future education of the adult which is a crucially important problem in America today. This type of education is something that goes beyond the granting of a degree, which may be only a degraded substitute for the regular liberal arts college degree. But I speak of education which is geared and is organized to meet the continual needs, intellectual and cultural, of a mature population, and which is so close to the best interests of a democratic citizenry.

Here in America the experiment of adult education particularly is one of the most unique in human history. I heard a recent talk in which an authority in management consultant work for industrial training said that the American adult education movement started 175 years ago with the group of citizens who drew up our constitutional government, the political essayists of our Colonial Period. They took upon themselves a process in self-education. It was a real experiment, one might say, which became the forerunner of our form of government.

So we need these leaders, men who as the products of our educational system with sound bases of spiritual and moral values, can lead us in the ideological conflicts that exist not only in this country but all over the world. We are competing or "racing" with conflicting philosophies about how people should get along with one another. The communists and we are in a race to turn out a better quality leader. Certainly education has an important part in putting us in the lead and keeping us there. As one educator said in drawing an analogy between our present struggle, and the fact that the Battle of Waterloo was won on the playing fields of Eaton, "Perhaps our struggle with communism for the next 50 years will be won on the playing fields of the public schools of the United States."

There is all too little time, and none to be wasted, in our attempt to develop through the combined efforts of education and industry, a type of leadership which will turn out to be the best possible in the world today.

The job of doing it is a long-term one for education. It will not come about overnight. Not alone by the budgeting of more educational funds, nor by the policy of a new administration—national or local—will the desired results be brought about.

The problems of leadership are not those that end at the plant door. Young America as it comes from our schools and colleges must be made to see that clearly. They must realize that their responsibility for industry's future, and their country's future, rests with all the people, both in the plant and at home. They must know that their free democratic economy is not a "carte blanche" guarantee from some autonomous power or bureau; but that all parts of their freedom, and the privileges that go with that freedom, rest on them and no one else.

To quote from one of our greatest Justices, Charles Evans Hughes, "The peril of this Nation is not in any foreign foe. We the people, are its power, its peril and its hopes."

The challenge is right now, not only for the young men but for those of this present generation—the challenge to love and admire those past accomplishments which are responsible for both the tangible and intangible values of our present civilization, and to inspire a thirst for future accomplishments in every phase of our world society.

As I listened to the citations presented last night to Mr. Andrews, and to the late Messrs. Andersen, Sterrett, and Sprague—and as I have listened to citations in previous years here—I was impressed with the fact that these men in The Accounting Hall of Fame were all men of great vision, rather than narrow specialists. And all seemed greatly concerned about both the professional and broader phases of education in their times.

The challenge I leave with you as representatives of a vital profession is this—stop "Looking Over Your Shoulder at Education," and face its problems squarely with a view to doing your share to bring about education-industry cooperation for the good of our youth, our land, and our world.

RESEARCH IN ACCOUNTING

By Thomas W. Leland
Professor of Accounting, Texas A. & M. College
College Station, Texas

Benjamin Franklin said, "The Eye of the Master will do more work than his Hand." Research, the seeing eye of accounting, needs a heavier work assignment. A quick look at current research and areas for fruitful future activity will be helpful in appraising the need for research.

Nature of Research

What is research? Research is studious inquiry, investigation or examination. The activity, however labeled, must have a quality variously described as careful, critical, diligent, exhaustive, scientific and unbiased.

The comments of Mr. Charles Kettering on the nature of research give it glamor and appeal that is not found in the dictionary definitions. He said:

> "Research is a high-hat word that scares a lot of people. It is nothing but a state of mind—a friendly, welcoming attitude toward change. It is going out to look for a change instead of waiting for it to come. Research, for practical men, is an effort to do things better, and not to be caught asleep at the switch. A research state of mind can apply to anything: personal affairs or any kind of business, big or little. It is the problem-solving mind as contrasted with the let-well-enough-alone mind. It is the composer mind instead of the fiddler mind. It is the 'tomorrow' mind instead of the 'yesterday' mind." The objectives of research include:

1. Discovery and interpretation of new facts.
2. Revision of accepted conclusions, theories or laws.
3. Practical applications of new conclusions.

Mere description is not research. Discovery of new facts is a step in the process, but it is not the end product. Research activity proceeds from relevant facts to reasoning and generalization. It applies conclusions to an existing problem. A research project that embraces only the first two objectives is called fundamental, theoretical or pure research. When it embraces an application to a specific problem, it is called applied research.

The American Accounting Association's committee on cost concepts and standards recently introduced its report with this excellent description of scientific method:

> "Scientific methods in general involve the establishment of valid conclusions on the basis of relevant facts. The valid conclusion sought may be anything from a fundamental general law to an exact measurement. It is required that the scientist ascertain what facts are relevant to the

conclusion sought, that he seek those facts, observe them competently, and measure their significance. Facts themselves are not only observed phenomena but the relationship between phenomena."

Scientific research starts with observations in nature or experiment. The observations lead to an hypothesis or theory. In the natural sciences the next step in methodology is a test of the hypothesis. If the tests do not support the hypothesis, the researcher makes new observations, and perhaps develops a modified or new hypothesis. When subsequent tests confirm any hypothesis, a principle or law is formulated.

In the natural sciences, tests usually can be conducted in laboratory experiments. In the social sciences, laboratory testing is generally difficult or impossible. The researcher in this area must frequently move from hypothesis to principle or other conclusion without adequate testing. Untested conclusions must be regarded as best guesses. Frequently they are unreliable.

Nevertheless, there is a tremendous power in research that takes the form of reflective thinking. This research is found in the market place, as well as in the halls of learning. Much of the work of the business executives consists of "sitting and thinking," before taking a decision leading to action.

Mistakes will be made. They will be numerous because of the missing tests. However, there is no need to apologize for the research or the mistakes, because the conclusions of the natural scientists, although supported by tests, are not always well-founded. They frequently are upset by new discoveries and new research. Truth in both the social and natural sciences should be regarded as an unfolding process. We must be prepared to accept new ideas and concepts in the years ahead, and to abandon some that are accepted today.

Fundamental Research in Accounting

Fundamental accounting research faces the limitation of all research in the social sciences. Testing of an hypothesis must be conducted on a broad scale. Adequate testing is expensive and requires prolonged effort. The testing may take place in thorough, critical review by professional and business leaders of ability and experience. It may be colored by personal and extraneous matters that defy separation or elimination. The conclusion that stands the test of acceptance becomes a generally accepted convention or principle.

The short-form audit report contains an expression of opinion by accountants that the financial statements present fairly the financial position and the results of operation, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. The misconceptions concerning the term "generally accepted principles," led the committee on terminology of the American Institute of Accountants to urge that every effort should be made to establish clearly the extent and limits of the significance of the phrase.

The dictionaries define a principle as a fundamental truth, and also as a law, rule or convention. There is a marked difference between fundamental truth and laws, rules or conventions. Truth is discovered; laws, rules and conventions are man-made.

The principles referred to in the opinion paragraph of the accountants certificate are founded on high ideals and moral purposes, but they relate to what is most useful rather than what is right or wrong. Obviously, they are not fundamental truths. Since they do not have legislative sanction, they should not be designated as man-made laws. Their authority rests on general acceptance, and accordingly, they are primarily concepts, conventions or standards rather than fixed rules.

Fundamental research in the development of accounting principles underlies a considerable part of the literature of the profession. Accounting texts and magazine articles are the media for the advancement of new ideas, their absorption into existing knowledge, and the rejection of practices and procedures deemed unsatisfactory. Noteworthy contributions have been made by many individual authors in formulating principles from the varying existing practices. They include Paton and Littleton, *An Introduction to Corporate Accounting Standards;* Sanders, Hatfield and Moore, a *Statement of Accounting Principles;* George O. May, *Financial Accounting.*

The viewpoint of practicing public accountants is best reflected in the Accounting Research Bulletins of the American Institute of Accountants. Another important review of principles, applied to specific corporate problems, is available in the Accounting Series Releases of the S.E.C. reflecting opinions of the chief accountant of the commission.

A survey of these materials provides evidence of contemporary search for basic concepts, but none of these sources offers a concise statement of an integrated body of principles applicable to the financial reports used in accounting practice. The nearest approach to such a statement is found in the American Accounting Association's statement, *Accounting Concepts and Standards Underlying Corporate Financial Statements.* This statement was prepared by the executive committee of the association and issued in June 1948. It was a revision of two previous statements which were issued in 1936 and 1941.

The A.A.A. statement was formulated because of a desire to assist in the development of accounting concepts and their wider acceptance. It was founded on a belief that principles and standards should be adhered to consistently, but it would recognize changes in accounting policy for the purpose of improving standards.

A comparison of the A.A.A. statement and the Accounting Research Bulletins brings to light many opportunities for further constructive research. Of primary importance is the question whether or not the various purposes served by accounting can be synthesized so as to permit the formation of concepts and standards and will be commonly accepted as guides to the achievement of the purposes.

If there are areas of special interest which cannot be brought within a common philosophy, what are they? What exceptions do they require in basic concepts and standards?

There are many parties interested in financial statements—management, current purchasers and sellers of interests, long-term stockholders or owners, creditors and credit agencies, governmental officials, employees, teachers, lawyers, financial analysts, and the general public. Are we to have common-purpose statements for all these groups? Which interests are to be dominant when there is a conflict in desired information? Research is needed to supply the answers.

Research relating to the objectives of accounting will necessarily consider social values and the general welfare. The task is not easy, but its completion is prerequisite to further scientific research. Once the goals are set, scientific methods can be employed to test each principle and procedure of accounting to determine whether it brings the profession closer to the accomplishment of its purposes.

Research is currently needed to reconcile conflicting views as to specific concepts and standards which confuse practitioners and the public. Examples of conflict are numerous. Perhaps the most serious conflict relates to the nature of net income, and the form of the income statement. Conflicting views as to inventory pricing, depreciation, taxes and prior-period errors may be thought of as encompassed within the different concepts of net income. These conflicts and others are commonly thought of as differences between the viewpoints of teachers and practitioners. They are not so easily explained because many teachers and practitioners are found on each side of the conflict.

A Proposal for a Research Program

A constructive proposal for a research program in accounting was presented by Mr. Gay Carroll, Comptroller of Humble Oil and Refining Company, in *The Accounting Review* of January 1951. He recommends continuous research in evolving accounting principles and methods. He recommends that the research be done by the following four agencies:

(1) A national committee, and the organizations that comprise that committee.
(2) Educational institutions.
(3) Associations of accountants, under a particular industry, where such associations exist, and
(4) Individual companies.

The national committee as conceived by Mr. Carroll is described in his proposal:

"1. That a national committee on accounting be organized, consisting of possibly twenty-one members, two or three to be selected from each of the following organizations: Controllers Institute, American Institute of Accountants, American Accounting Association, National Association of Cost Accountants, Institute of Internal Auditors, American Economic Association, National Association of Credit Men, and the Securities and Exchange Commission.

2. That an executive committee of the national committee, consisting of say, seven members, one representative from each of the organizations represented on the national committee, be set up to function for the larger committee.

3. That the executive committee of the national committee appoint a director of research, and supply a staff sufficient to provide:
   a. A statement of accounting principles, which when passed on affirmatively by the national committee, can in fact be called a statement of accepted principles of accounting.
   b. A bulletin on accounting terminology and definitions; and
   c. Other publications devoted to improvement in accounting statements, techniques, procedures, and the like, which the research staff may be called to prepare."

The following statement of Mr. Carroll further reflects his views concerning the functioning of the committee:

"This proposal is intended only as a suggested framework within which detailed procedures might be developed. Provisions should possibly be made, whereby the present accounting organizations would approve or exercise veto power over conclusions and recommendations of this committee. Such a committee cannot immediately solve all the problems . . . nor can it fulfill each accountant's responsibility to provide management with information that will serve as a reliable basis for executive decisions. But it can function effectively to help the accountants meet their total responsibility to business and to the public. The project can be adequately financed, and the job can be done."

Progress in the direction of cooperative research is evident in the overlapping organization ties of the research committee of each of the national accounting organizations. The overlap seems to be greatest in the A.A.A., whose teaching members commonly hold membership in A.I.A., C.I.A., I.I.A. or N.A.C.A.—frequently in as many as three of these organizations. Overlap also occurs in the research committees of other organizations. The A.I.A. committee on accounting procedure, for example, generally has one or more members of each of the other accounting organizations. The N.A.C.A. research committee is composed of industrial accountants, public accountants, and accounting teachers.

The national accounting organizations commonly circulate proposed announcements of importance before their release in final form. They have also used consultants from other accounting organizations, and consultants other than accountants. These forms of cooperation are healthy and conducive to effective accounting research.

The joint council proposed by Mr. Gay Carroll would seem to be a logical step toward improvement. It carries promise that conflicting past pronouncements may be reconciled, and it provides the machinery for modification of concepts if changes are desirable or necessary. His proposal deserves careful consideration. Perhaps we need research on research objectives and research organization for all accountants.

The Rand Corporation (Project Rand) has been publicized recently. *Fortune* Magazine styled this project as the Air Force's big brain buying venture, and called attention to the promise of its scientific analysis of warfare for business. Project Rand has a staff of 400 trained scientists, technicians and their assistants working together in the atmosphere of a downtown university, on long range, scientific, military research designed to aid Air Force decisions.

A battery of techniques by scientifically trained men has been used in a similar manner in business. Mr. G. E. Kimball in the April 1951 issue of *Fortune* Magazine, lists Chesapeake and Ohio, General Electric, United States Rubber, duPont, Monsanto and other corporations as users of the techniques.

Your speaker is impressed by the possibilities of professional progress through similar research using accountants, mathematicians, statisticians, psychologists, economists, political scientists, sociologists and other scientifically trained men.

Research of National Accounting Organizations

The research of national accounting organizations is discussed capably and thoroughly by Dr. Charles T. Zlatkovich in his doctoral dissertation.[1] The writer's comments are influenced to a considerable degree by his analysis and conclusions.

Research of the National Association of Cost Accountants[2]

The research contributions of N.A.C.A. have been substantial. The detailed work is done by the Research Staff composed of employees in the New York office. Guidance of research rests with a Committee on Research composed of thirty members of the association. The committee outlines objectives, selects areas of study, assigns studies to the research staff, develops conclusions based on the data compiled by the staff, and reviews and revises the reports and findings.

> The following is quoted from the N.A.C.A. statement of research policies: "While it is considered important to bring together factual information concerning the actual accounting practices of American industry, research reports are not limited to purely descriptive material. An endeavor is made to discover the reasons behind each company's choice of methods, and the ways in which accounting techniques have been adapted to special problems of its industry and to the requirements of its management. As expressed in a statement of objectives prepared by the Committee shortly after its formation:
>
> > 'The work of analysis will seek to examine the reasons for the several cost accounting practices, the managerial purposes they are intended to serve, and to consider how well the cost practices do in fact achieve those purposes. This phase of the work will bring into sharp focus the many uses to which cost accounting figures are put. It is likely to develop that different purposes require different procedures, so that a priority of purposes, determined for proper reasons of business policy, will be tantamount to determining a priority of method. Choices of method occur, for example, with respect to charging materials into process, and with the complementary question of inventory valuation. Different answers result according as emphasis is laid upon profit determination, long or short run views, inventory values in the balance sheet, operating factors, or a number of other considerations.'
>
> By adding to the factual and descriptive information about accounting practices available to members of the Association, and by analyzing the reasons underlying these methods, it is hoped that better industrial accounting practice will develop.
>
> "In accordance with policy established by the National Board of Directors, the Committee does not issue pronouncements or pass judgment on matters of accounting practice. The reasons for this are (1) the purpose of the Association is educational, and it does not regulate the practice of its members, and (2) it is felt that progress in accounting will be most

[1] Research Activities of National Accounting Organizations, 1952.

[2] The writer acknowledges the helpful material received from Dr. Ray P. Marple, Assistant Secretary of N.A.C.A.

rapid if each accountant is free to develop his own methods unhampered by rules which might tend to limit his exercise of initiative in making the best possible use of accounting techniques for his own purposes."

Recent studies of N.A.C.A. have dealt with accelerated amortization, tax amortization of emergency facilities, variable budgeting and break-even points, and manufacturing costs variances. The current year projects include projects on direct costing, and product costs for pricing purposes.

Research of the American Accounting Association

Comment has previously been made on the research work of A.A.A. leading to the statement of *Accounting Concepts and Standards Underlying Corporate Financial Statements*. Since 1950 research has been directed to the determination and expression of desirable accounting objectives and principles. Emphasis remains on long-range objectives and not on recommendations for immediate adoption in current practice.

The preparation and publication of statements is now the responsibility of the committee on Accounting Concepts and Standards. The Executive Committee of the Association will designate the years in which a revision of the comprehensive statement is to be undertaken. Subsequent revisions will be issued as a report of the committee on Accounting Concepts and Standards.

Supplementary statements completed to date include:

No. 1. *Reserves and Retained Income.*
No. 2. *Price Level Changes and Financial Statement.*
No. 3. *Current Assets and Current Liabilities.*
No. 4. *Accounting Principles and Taxable Income.*

The Committee has under preparation the following prospective statements to which considerable effort has been devoted:

1. The LIFO Method of Inventory Evaluation.
2. Allocations of Income Taxes.
3. Stock Dividends, Splits and Rights.
4. Foreign Operations.

Possible statements for future publications to which consideration has been given are as follows:

1. Uses and Purposes of Financial Reports.
2. Profits, If Any, On Treasury Stock.
3. Conservation.

The Association's committee on Cost Accounting Concepts and Standards is working on a statement of cost-accounting principles. Other committees have assignments which are primarily research projects, for example:

1. Preparation of an accounting teacher's manual.
2. Exploratory studies directed toward development of principles and practices essential to the preparation of national balance sheets.
3. The use of visual aids in teaching.
4. Improvement of the quality of internship training.
5. Improvement of auditing education.
6. Development of acceptable curriculum and staff standards for accounting instruction.

The Association regularly elects a director of research. Dr. Ralph C. Jones, the present director, is conducting a pilot study designed to determine the influence which price level changes exert upon accounting data, and the problems involved in measuring such influence. The director of research is also responsible for assembling and publishing lists of research projects in accounting. The most recent list appeared in the *Accounting Review* in April 1953.

Research of the American Institute of Accountants[3]

The American Institute of Accountants has a research department which services certain technical committees of the Institute. These include the following: accounting procedure; auditing procedure; cooperation with bankers; federal taxation (which has major subcommittees on (a) current tax legislation, (b) long-range tax policy, and (c) tax administration); national defense (which has several major subcommittees); relations with SEC; technical sessions; and terminology. Assistance may take several forms, but often includes fact-finding, drafting of bulletins, statements, and reports in preliminary form, and otherwise facilitating work. Some of the things recently accomplished or currently in process by some of the busier committees include:

Accounting Procedure. The major activity of this committee for almost three years has been work on "Restatement and Revision of Accounting Research Bulletins." This project is now nearing completion; all ballots are in, and it is expected the document which will supersede the present bulletins will be published in June. Terminology bulletins are being separately restated. Within the past few months the committee has completed and issued three bulletins (No. 11 Rev., No. 37 Rev., and No. 42). It has been at work for some time on a bulletin dealing with the general subject of accounting for pensions and pension plans.

Auditing Procedure. The committee is engaged in a nationwide survey of audit reports submitted to banks, the results of which will be used in determining what further steps are necessary in carrying out the

[3] Based on information supplied by Dr. Charles T. Zlatkovich.

committee's long-range educational program to obtain greater compliance with auditing standards. Twenty-nine state societies are now cooperating in this project; it is expected that at least five hundred banks will fill out questionnaires on not less than 10,000 audit reports. By summer, the Institute plans to publish a booklet on long-form audit reports; in some respects this will be a miniature equivalent of *Accounting Trends and Techniques in Published Corporate Annual Reports;* it will also contain several specimen reports reproduced in their entirety. There are subcommittees at work on special purpose reports, standard bank confirmation forms, reporting of events occurring subsequent to the balance-sheet date, and possible revision of the short-form report.

Federal Taxation. Fifty-eight recommendations for amendment of federal tax laws were submitted to Congress in January. These were reported in the December, 1952, *Journal of Accountancy.* A special committee to establish sound accounting principles for income tax purposes has just been appointed, following a suggestion made by the chairman of the House Ways and Means Committee.

Terminology. A counterpart to the accounting committee's project of restating and revising the Accounting Research Bulletins is the Terminology Committee's project restating the bulletins dealing with terminology. This work is not as far along as the other restatement, but will quite possibly be completed in 1953.

Besides serving the aforementioned committees, the research department operates a technical inquiry service. Members who have (non-tax) accounting or auditing problems submit them to the service for assistance. At the present time the service answers about 400 inquiries a year by letter and handles quite a few by telephone as well. When a problem is thought to be of general interest it serves as the basis of an item in Mr. Carman Blough's regular column in the *Journal.*

Research of Controllers Institute of America

Since its establishment in 1951, Controllers Institute of America has sponsored numerous research activities in the philosophy of controllership, and the techniques, standards and practices which produce findings for the guidance of top financial management. It currently conducts research through a research arm known as Controllership Foundation, Inc.

Many of the studies relate to the work of controllers: Techniques of controllership, tax aspects of controllership, contributions of controllership, and the organization of the controllers office, are some examples.

A list of recent research publications follows:

"The Impact of Budgets on People"
"Management Planning for Corporate Taxes"
"Business Consultants—Their Uses and Limitations"
"Defense Mobilization—What Management is Doing"
"Providing Facts and Figures for Collective Bargaining: The Controller's Role"
"Setting Salaries in the Controller's Department"
"Business Forecasting"
"Meeting the Challenge of the Buyer's Market"
"Evaluating Managerial and Supervisory Jobs in the Controller's Department"
"Controllership in Modern Management"
"Depreciation Policy when Price Levels Change"
"What People Want to Know About Your Company"

Manuscripts of two survey reports are in final stages of preparation. One deals with controller's role in management-employee communications, and the other with organization of the controller's service to management.

Recently the controllers were asked to inform C.I.A. of their experience in research within their organizations. Eight companies reported the operation of full-time accounting research departments or staffs with one to five employees. All eight companies agreed that the program had been productive, and several indicated that they contemplated the expansion of accounting research personnel.

Other Research

Time does not permit a discussion of research activities of other organizations, notwithstanding their important contributions. The Securities and Exchange Commission, the New York Stock Exchange, the Federal Reserve Banks, the Institute of Internal Auditors, state societies of C.P.A.'s, Petroleum Accountants, and other bodies should be listed as research agencies.

Considerable research in accounting is conducted in the colleges and universities. Most of this research has been at the graduate level. Graduate programs for accounting majors emphasize the importance of study and training in research techniques. Group research on theory and applied subjects takes much of the time of graduate seminars. Individual research is required for seminar papers.

The published lists of subjects show an unfortunate concentration on narrow descriptive subjects such as the system of a postwar business or industry. However, there has been a healthy improvement over the years in the general pattern. Further improvement can come from closer familiarity with current and long-range problems. Controllers, Internal

Auditors, Cost Accountants, and public practitioners can lend encouragement to the schools in bringing about the desired improvement. Scholarship awards are needed. Data for research must be provided. Accounting teachers and graduate students need short-term employment designed to give them a background on business problems that lend themselves to research study.

In preparing this paper, selected accounting teachers were asked these questions:

1. Do we need better cooperation in accounting research?
2. Why has not a better cooperative program of research been developed?
3. Is the fault that of accounting teachers, public accountants, or a result of general neglect by all parties concerned?
4. How can the situation be improved?

Generally the replies indicate that better cooperation is needed for research in accounting. The teachers state that public accounting firms, business enterprises, and accounting organizations are ready and even eager to cooperate in providing employment, and in making research materials available.

Opinion is divided as to the reasons for not taking advantage of the available opportunities. Some think it is the result of lack of funds to cover traveling expense and compensation for the student or staff researchers. Others state that there is no lack of resources for those qualified and interested. All agree that there is no shortage of research problems, but one teacher attributes the lack of cooperation in research to the difficulty of finding a problem of interest to the researcher, and profit to the party for whom the research is undertaken. Perhaps unrestricted contributions for research would meet the difficulty he has experienced.

Many schools require a master's thesis. Since at this level it is difficult to carry a student through research leading to new knowledge, schools commonly accept a descriptive-type thesis, or so-called library research. The former trains in accurate observation of current practice, discrimination in selecting and analyzing material, and ability to write. The latter forces the student to take a position relating to a controversial subject, to analyze the arguments for and against, and finally to take and defend his position. At the doctoral level, there are notable and outstanding contributions to accounting knowledge and thought in some of the dissertations.

As previously stated, *The Accounting Review* publishes lists of research projects in accounting at colleges and universities. It is interesting to observe the areas of the research projects published in April 1953.

A tabulation by subject areas and levels follows:

Subject Area	Level of Research: Masters	Doctoral	Faculty
Cost	14	6	
Accounting Systems, Case and Industry Studies	34	1	
Theory	18	12	2
Taxation, Government Contracts and Renegotiation	28	4	
Managerial Accounting, Budgeting, Controllership and Internal Auditing	9	3	1
Reports and Statements	9	5	1
Consolidations, Reorganizations, Insolvencies, Bankruptcies and Capital Readjustments	2		
Auditing	6		
Governmental, Institutional, and Fiduciary Accounting	8	2	
History of Accounting	1	1	1
Profession of Accounting	8	2	
Education	3	1	
Governmental Regulations	3		1
Miscellaneous	8	4	
Total	151	41	6

Constructive leadership is needed within the schools. More than one of the correspondents hold the view that substantial progress can come if the schools will approach the cooperating organizations with definite proposals for worthwhile projects.

Accounting as a Tool of Research

Accounting is frequently called a research tool. Sometimes it is classed as a branch of statistics since it concerns collection, classification, presentation, and analysis of financial data. Accountants would find it helpful to acquire mastery of the broader techniques of economic statisticians. Unfortunately they generally have failed to develop such skills and consequently their competence as researchers is limited. The deficiency is receiving considerable attention today as a result of a growing awareness of possibilities in the use of statistical methods in auditing, statement analysis, cost control and the problems previously identified as those of accountants.

Research in the Individual Accounting Firm[4]

A number of accounting firms have established separate research departments. Lybrand, Ross Bros. and Montgomery took this action prompted by the realization that requisite research could not be satisfactorily achieved by assigning projects, as they came up, to staff members, who, because of their responsibility to client, would, perforce, be able to undertake it on only a spare-time basis. Before undertaking to outline the manner in which research is carried on, it will be well to consider the objectives which are in mind. These are:

1. To insure that we keep abreast of current trends in accounting.
2. To ascertain general practice as applied to specific problems.
3. To aid in achieving uniformity of firm practice.
4. To aid in maintaining the level of staff knowledge by keeping available technical books and periodicals in the firm library.

Research relating to tax matters or systems is handled by separate departments.

The general aim of the research department is the accumulation of data and knowledge to enable it to act as a sort of clearing house of information. Specific procedures followed in order to achieve this general aim are outlined in the following paragraphs.

A review is made of current technical periodicals such as *The Journal of Accountancy*, *The Accounting Review*, *The Harvard Business Review*, Publications of the various state accounting societies, Bulletins of the National Association of Cost Accountants, and statements issued by the Securities and Exchange Commission. A current index is maintained of those articles which appear likely to be of especial interest.

A review is also made of business periodicals for expressions of opinion on current topics of a nature which may influence accounting trends.

Published reports of companies are reviewed. These include both reports to stockholders and registration statements, and cover companies for which the firm acts, and those for which other firms are auditors. In the case of clients of the firm, one purpose of this review is to observe that a reasonable degree of uniformity is followed as to accounting principles and methods, and as to the extent of disclosure of information. In

[4] Based on material supplied by Mr. Thomas J. Cogan of Lybrand, Ross Bros. and Montgomery.

all cases a study is made of accounting followed to deal with situations arising from changing business practices and conditions, so that the firm may be conversant with generally adopted procedures for these situations; current examples of this would be treatment of employees' stock options and amortization of emergency facilities. The review of published reports also includes noting, for possible future use, the treatment of unusual transactions. Research into published material has been considerably facilitated since the publication by the American Institute of Accountants of "Accounting Trends and Techniques."

The research department also consults with the American Institute of Accountants, and the New York State Society of Certified Public Accountants with reference to specific accounting problems which may arise in firm practice. Conversely, research will be undertaken in response to questions submitted to those bodies by other firms and practitioners.

The maintenance of a comprehensive library is of prime importance to an accounting firm. In order to assure that the firm's library is kept up-to-date and comprehensive, a continuous review of new accounting literature is made. This work is facilitated to a great extent by the excellent reviews of new books which are included in periodicals such as *The Journal of Accountancy*, and *The Certified Public Accountant*.

Upon request an investigation is made into any specific problem which is submitted by any of the offices of the firm. These investigations constitute in essence an application to the problem under consideration of the type of review discussed in the preceding paragraphs.

Past and Future

Training in the art of research will promote research. Samuel Johnson expressed the idea in these words, "Knowledge always desires increase; it is like fire, which must first be kindled by some external agent, but which will afterwards propagate itself."

Today the profession is experiencing growing pains. This means real opportunities, for research accountants have an enviable reputation, and as a result the calls for their services are many. Research can improve their reputation, and the quality of their service. It is no discredit to present leaders to point to certain areas which need improvement, because professional standing is not the accomplishment of any one generation. Today's leaders recognize these needs: a more exact and more readily understood terminology; a classification of the objectives of accounting; a synthesis of principles based on the definition of objectives; elimination of undesirable practices; improved services to all who use accounting skills or the product of these skills; and finally an acceptance of greater social responsibilities.

Albert Sweitzer in *Out of My Life and Thought,* stresses the danger of following the pattern of Epigoni—a generation of hero worshippers following those who lived in a great age. Accountancy has experienced a thrilling past, and our feeling of pride as we take a retrospective view of professional growth is natural and commendable. But let those who enter the profession, today and tomorrow, keep the will to progress. CPA's have a rich inheritance. Research will help them live up to it.

ACCOUNTING ROSTER

ADAMS, JAMES, W. E. Langdon & Sons, Columbus
ALLISON, FRANCIS, Ohio State University, Columbus
ANDREWS, T. COLEMAN, Bureau of Internal Revenue, Washington, D. C.
ANKERS, RAYMOND G., Lybrand, Ross Bros. & Montgomery, New York, N. Y.
AREND, CARL A., Armco Steel Corporation, Middletown
ARNOLD, CHARLES R., Ohio State University, Columbus
ARNOLD, FRANK, Arnold, Hawk & Cuthbertson, Dayton
ARNOLD, K. U., Columbus & Southern Ohio Electric Company, Columbus
ASHMAN, R. D., Ernst & Ernst, Cleveland
ASSION, LEE T., The Buckeye Steel Castings Company, Columbus

BAKER, LAWRENCE F., United Aircraft Products, Inc., Dayton
BANGHAM, ROBERT R., Ohio Society of CPA's, Columbus
BARNES, RICHARD E., E. C. Redman, Columbus
BARSTOW, C. BYRON, Trout & Barstow, Dayton
BASSETT, ARTHUR T., The City Loan & Savings Company, Lima
BATTELLE, DON D., Battelle & Battelle, Dayton
BATTELLE, GORDON K., Battelle & Battelle, Dayton
BATTELLE, L. G., Battelle & Battelle, Dayton
BAUGHMAN, VIRGIL, The Hewitt Soap Company, Inc., Dayton
BAUHOF, R., Ernst & Ernst, Cleveland
BEAMER, E. G., Haskins & Sells, Cleveland
BEARD, LOWELL D., Wall Cassel & Groneweg, Dayton
BEARD, PAUL H., The Specialty Papers Company, Dayton
BELL, DOYT E., The Bonney-Floyd Company, Columbus
BERGER, ROBERT O., JR., Price Waterhouse & Company, Cleveland
BERLEKAMP, NEIL D., The Howard Zink Corporation, Fremont
BINGE, HAROLD C., The Massillon Steel Casting Company, Massillon
BLASER, J. P., Meaden & Moore, Cleveland
BOCK, FRANKLIN H., Consolidated Paper Company, Monroe, Michigan
BOLAND, FRANK A., Keller, Kirschner, Martin & Clinger, Columbus
BOLON, Ohio State University, Columbus
BORDNER, DALE E., United States Trotting Association, Columbus
BOWMAN, F. C., The Ohio Steel Foundry Company, Lima
BRADMILLER, LIONEL F., Wall, Cassel & Groneweg, Dayton
BRANDON, Ohio State University, Columbus
BRANDT, HAROLD P., Republic Steel Corporation, Cleveland
BRASTED, F. KENNETH, National Association of Manufacturers, New York, N. Y.
BRITTON, GLEN H., W. E. Langdon & Sons, Columbus
BROWN, LLOYD D., Peter Kiewit Sons' Company, Waverly
BUCCALO, JAMES N., Keller, Kirschner, Martin & Clinger, Columbus
BUCK, JOHN P., Lybrand, Ross Bros. & Montgomery, New York, N. Y.
BUENZOW, LES, Touche, Niven, Bailey & Smart, Dayton
BURNHAM, WALTER C., Ohio State University
BYRD, H. M., Farm Bureau Insurance Company, Columbus
BYRNE, JAMES, Arthur Andersen & Company, Cleveland

CALLAHAN, FRANK C., Richard Smethurst and Company, Cincinnati
CALLAHAN, JOSEPH, The Cincinnati Gas & Electric Company, Cincinnati
CAMPBELL, E. F., The Fyr-Fyter Company, Dayton
CAMPBELL, RONALD G., Trout & Barstow, Dayton
CARTER, JAMES G., Michigan State College, East Lansing, Michigan
CASE, HARRY N., Lybrand, Ross Bros. & Montgomery, New York, N. Y.
CASSEL, J. C., Wall, Cassel & Groneweg, Dayton
CHAPIN, KENNETH L., Bendix Aviation Corporation, Cincinnati
CHAWNER, JACK L., Price Waterhouse and Company, Pittsburgh, Pa.
CHRISMAN, H. JEWETT, Battelle & Battelle, Dayton
CHRISTIANSEN, IRVING K., John Carroll University, Cleveland
CLAIRE, RICHARD S., Arthur Andersen & Company, Chicago, Illinois
CLARK, CHARLES P., The Julian & Kokenge Company, Columbus
CLARK, L. FREDERICK, Wall, Cassel & Groneweg, Dayton
CLINGER, RALPH H., Keller, Kirschner, Martin & Clinger, Columbus
COBEN, LAWRENCE, Ohio State University, Columbus
COE, RICHARD, The Denison Engineering Company, Columbus
COLLISON, J. B., Arthur Young and Company, Cleveland
COX, AL. R., Jones, Cox & Lotz, Canton
COX, R. CARSON, JR., Ohio State University, Columbus
CRAWFORD, RUSSELL L., Harrop Ceramic Service Company, Columbus
CROUSE, J. L., The Ohio Steel Foundry Company, Lima
CRUMLEY, CHARLES C., Arthur Young & Company, Cleveland
CURL, JOHN W., Keller, Kirschner, Martin & Clinger, Columbus

DALTON, H. L., Konopak & Dalton, Toledo
D'ANNIBALLE, ARTHUR J., Steubenville
DARGUSCH, CARLTON, Ohio State University, Columbus
DAVIS, C. X., Battelle & Battelle, Dayton
DAWSON, DONALD H., Uebel, Monroe & Faber, Cleveland
DAY, LEWIS I., The Buckeye Steel Castings Company, Columbus
DEERING, JAMES, The Cincinnati Gas & Electric Company, Cincinnati
DEVLIN, FRANK J., John Carroll University, Cleveland
DICKERSON, WILLIAM E., Ohio State University, Columbus
DICKINSON, JAMES E., Ohio State University, Columbus
DIEHL, LOWELL E., Hathaway & Hathaway, Columbus
DIXON, NORWIN, Ohio State University, Columbus
DOAN, MILES J., The Cincinnati Gas & Electric Company, Cincinnati
DOHNER, NORMAN A., Robert N. Lloyd, Dayton
DOMIGAN, HORACE W., Ohio State University, Columbus
DREXEL, WILLIAM A., Keller, Kirschner, Martin & Clinger, Columbus
DRYDEN, E. R., Touche, Niven, Bailey & Smart, Dayton
DUFFUS, PARMALEE W., Parker, Bolon & Company, Columbus
DUFFUS, WILLIAM W., American Greetings Corporation, Cleveland

ECHT, IRVING, B. F. Goodrich Company, Akron
ECKLEBERRY, GEORGE W., Ohio State University, Columbus
EDDY, R. B., Ranco Inc., Columbus

EDWARDS, MARION, Farm Bureau Insurance Company, Columbus
EICHHORN, H. C., Hydraulic Press Manufacturing Company, Mt. Gilead
EILERS, A. ARTHUR, Keller, Kirschner, Martin & Clinger, Columbus
ELLIOTT, JAMES H., The Specialty Papers Company, Dayton
EMERY, JOHN M., Columbus & Southern Ohio Electric Company, Columbus
EVANS, ROBERT, The Cincinnati Gas & Electric Company, Cincinnati
FAIRWEATHER, D. H., The American Appraisal Company, Cleveland
FEDERER, JOHN W., Arthur Andersen & Company, Cleveland
FELDMAN, BRUCE S., Ohio State University, Columbus
FENNER, J. B., The Electric Auto-Lite Company, Toledo
FERGUS, MORRIS F., The Fyr-Fyter Company, Dayton
FERTIG, PAUL E., Ohio State University, Columbus
FEY, R. R., Metal Specialty Company, Cincinnati
FICCOCELLA, PHILLIP A., Keller, Kirschner, Martin & Clinger, Columbus
FINKE, PHILLIP W., Keller, Kirschner, Martin & Clinger, Columbus
FISHER, J. W., The Ohio Steel Foundry Company, Lima
FLAYLER, W. M., Moraine Products Division, GMC, Dayton
FORD, RUTH C., Keller, Kirschner, Martin & Clinger, Columbus
FOSTER, HOWARD E., Farm Bureau Insurance Company, Columbus
FOUSE, EDWIN L., The Denison Engineering Company, Columbus
FRAAS, EDWIN R., Keller, Kirschner, Martin & Clinger, Columbus
FRIEDLY, M. M., Moraine Products Division, GMC, Dayton
FROEBE, JOHN A., Fenn College, Cleveland
FULLERTON, CHARLES, Farm Bureau Cooperative, Columbus
FURRY, VIRGIL L., Columbus Coated Fabrics Corporation, Columbus

GABELE, ROBERT F., Peat, Marwick, Mitchell & Company, Cleveland
GALL, ELMER R., M & R Dietetic Laboratories, Inc., Columbus
GARDNER, GORDON F., Price Waterhouse & Company, New York, N. Y.
GARNER, S. PAUL, University of Alabama, Alabama
GARRITT, HERBERT L., Ohio State University, Columbus
GATES, JOSEPH L., E. C. Redman, Columbus
GEHRING, B. R., Kilgore, Inc., Westerville
GERLACH, WILLIAM R., Gerlach and Company, Elyria
GETROST, H. E., Somerville & Company, Huntington, W. Va.
GETZ, HOMER C., Armco Steel Corporation, Middletown
GHESQUIERE, C. J., The Detroit Edison Company, Detroit, Mich.
GILLESPIE, WILLIAM H., JR., Trout & Barstow, Dayton
GLENN, DON, Ernst & Ernst, Columbus
GLOS, R. E., Miami University, Oxford
GOCKEL, CHARLES A., JR., The Specialty Papers Company, Dayton
GOELZ, ROBERT L., Ohio State University, Columbus
GOGLE, JOHN M., Battelle & Battelle, Dayton
GORDON, JACOB, Akron
GRAFF, F. W., John Carroll University, Cleveland
GRAHAM, BERL G., Gans & Cherrington, Cincinnati
GRAY, S. W., Hoover Company, North Canton
GREEN, Dayton Power & Light, Dayton

GREER, HOWARD C., Ohio State University, Columbus
GRIMES, EDMUND L., Commercial Credit Company, Baltimore, Md.
GUEHL, JOHN J., Trout & Barstow, Dayton

HAMMERMAN, BEN B., Ben B. Hammerman, Dayton
HAMPTON, JOSEPH E., Ohio State University, Columbus
HARBRECHT, ROBERT, Battelle Memorial Institute, Columbus
HARVEY, JOHN L., Arthur Young & Company, Pittsburgh, Pa.
HASSLER, RUSSELL H., The Harvard Graduate School, Boston, Mass.
HATCH, CLAYTON D., The Warner & Swasey Company, New Philadelphia
HATHAWAY, D. E., Hathaway & Hathaway, Cincinnati
HAY, ROBERT D., Ohio State University, Columbus
HECKERT, J. B., The Ohio State University, Columbus
HEILMAN, DORIS M., Defiance
HEILMANN, ERNEST, University of Minnesota, Minneapolis, Minn.
HELKER, G. C., Moraine Products Division, GMC, Dayton
HENTON, KEITH T., Raymond Manufacturing Company, Corry, Pa.
HESSLER, ROBERT, Willys Motors, Inc., Toledo
HIGHFIELD, GRACE S., Keller, Kirschner, Martin & Clinger, Columbus
HILLIAN, H. J., Airtool Manufacturing Company, Springfield
HITTNER, STANLEY A., Cincinnati
HIXSON, PAUL D., Wright Air Development Center, Wright Patterson Air Force Base, Ohio
HOFFMAN, J. M., Battelle & Battelle, Dayton
HOMAN, LAWRENCE H., Lybrand, Ross Bros. & Montgomery, Detroit, Mich.
HOMAN, ROBERT W., Lybrand, Ross Bros. & Montgomery, Cleveland
HOOK, CHARLES R., Armco Steel Corporation, Middletown
HOPKINS, LEONARD L., Keller, Kirschner, Martin & Clinger, Columbus
HOWARD, RODNEY E., Davey Compressor Company, Kent
HOWE, HAROLD W., The H. C. Godman Company, Columbus
HOWE, W. ASQUITH, Ohio State University, Columbus
HOYT, PAUL I., Ohio State University, Columbus
HRENKO, PAUL, Battelle Memorial Institute, Columbus
HUDSON, N. PAUL, Ohio State University, Columbus
HURWITZ, MORRIS S., The Railway Supply and Manufacturing Company, Cincinnati
HURWITZ, WILLIARD A., Ohio State University, Columbus
HUTSELL, MICHAEL, The Massillon Steel Casting Company, Massillon

JACKSON, JOSEPH, Robert N. Lloyd, Dayton
JAHN, ARTHUR C., Arthur C. Jahn & Company, Columbus
JENCKS, WILLIAM B., Ohio State University, Columbus
JOCKERS, CLIFFORD, The Cincinnati Gas & Electric Company, Cincinnati
JOHNSON, H. K., E. W. Bliss Company, Canton

KANORR, BEVAN, Moraine Products Division, GMC, Dayton
KAYATI, S. G., Warner & Swasey Company, New Philadelphia
KEHLENBRINK, T., E. C. Redman, Columbus
KELLER, LAURENCE D., Keller, Kirschner, Martin & Clinger, Columbus

KELLY, CARL F., National Electric Coil Company, Columbus
KENT, RALPH E., Arthur Young & Company, New York, N. Y.
KIEHL, DENNIS E., Ohio State University, Columbus
KINNEY, H. M., Columbus Bolt & Forging Company, Columbus
KNAUFF, PAUL N., The Ohio Leather Company, Girard
KNOLLMAN, THEODORE, Omar, Inc., Columbus
KORK, LOUIS D., Lybrand, Ross Bros. & Montgomery, Cleveland
KRAPP, R. G., Thew Shovel Company, Lorain
KRAUSE, JAMES R., Arthur Andersen & Company, Cleveland
KRAUSS, E. L., The Federal Glass Company, Columbus
KRETZMAN, THEODORE A., Alten Foundry and Machine Works, Lancaster
KUNTZ, CHARLES A., Ohio State University, Columbus

LAIHR, JOSEPH G., J. A. Wood & Company, Springfield
LANGDON, ELMORE G., W. E. Langdon & Sons, Columbus
LANGDON, PAUL R., Battelle Memorial Institute, Columbus
LANGDON, W. E., W. E. Langdon & Sons, Columbus
LAWRENCE, PHILIP W., WJW, Inc., Cleveland
LELAND, THOMAS, Texas A & M College, College Station, Texas
LEVENING, T. C., The Denison Engineering Company, Columbus
LEY, J. WAYNE, Ohio State University, Columbus
LLOYD, ROBERT N., Dayton
LONG, KENNETH H., J. A. Wood & Company, Springfield
LONGANBACH, L. H., The Ohio Fuel Gas Company, Columbus
LORTZ, ROBERT D., Prima Footwear, Inc., Columbus
LUCAS, MERRITT J., Price Waterhouse & Company, Cleveland
LUTZ, R. H., Columbus Coated Fabrics Corporation, Columbus
LUXON, NORVAL NEIL, Ohio State University, Columbus

MADER, RICHARD O., Guarantee, Title and Trust Company, Columbus
MAHON, JAMES J., JR., Lybrand, Ross Bros. & Montgomery, Philadelphia, Pa.
MARKEL, ROY A., Arthur Young & Company, Toledo
MARKS, THEODORE B., Jacob Gordon, Akron
MAROT, W. W., Surface Combustion Corporation, Columbus
MARPLE, RAYMOND P., National Association of Cost Accountants, New York, N.Y.
MARQUARD, J. L., Kilgore, Inc., Westerville
MARTIN, JOHN C., Keller, Kirschner, Martin & Clinger, Columbus
MARTIN, RICHARD F., The Standard Register Company, Dayton
MASSON, J. O., Wooster Brass Division, Wooster
MAYNARD, ROBERT M., Price Waterhouse & Company, New York, N. Y.
McCORMICK, KENNETH, Battelle & Battelle, Dayton
McCOY, JAMES R., Ohio State University, Columbus
McGILL, BETTY T., Keller, Kirschner, Martin & Clinger, Columbus
McGURR, FRANK J., John Carroll University, Cleveland
McLOUGHLIN, G., Omar, Inc., Columbus
McNEESE, ROBERT W., Arthur Andersen & Company, Cleveland
MEADEN, DOUGLAS S., Meaden & Moore, Cleveland
MERRICK, CHARLES E., Arthur Young & Company, New York, N. Y.

MERTZ, B. J., Buckeye Union Casualty Company, Columbus
MEYERHOFF, JACK F., Arthur Andersen & Company, Cleveland
MILES, ROBERT C., Ranco, Inc., Columbus
MILLER, HERMANN C., Ohio State University, Columbus
MILLER, ROBERT M., Gar Wood Industries, Inc., Wayne, Michigan
MILLER, RUSSELL W., Standard Register Company, Dayton
MILLER, S. D.. Toledo
MILLIGAN, DANFORD D., Keller, Kirschner, Martin & Clinger, Zanesville
MINUTELLI, BENJAMIN, Keller, Kirschner, Martin & Clinger, Columbus
MITCHELL, COLLIN F., JR., The Hewitt Soap Company, Inc., Dayton
MITCHELL, WILLIAM A., Lybrand, Ross Bros. & Montgomery, New York, N. Y.
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